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TRANSCRIPT OF RECORD

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Supreme Court of the United States

OCTOBER TERM, 1936/7

No. 832/16

HENRY O. HALE AND ELIZABETH C. HALE,
APPELLANTS,

vs.

THE IOWA STATE BOARD OF ASSESSMENT AND REVIEW

APPEAL FROM THE SUPREME COURT OF THE STATE OF IOWA

FILED MARCH 22, 1937.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1936

No. 832

HENRY O. HALE AND ELIZABETH C. HALE,
APPELLANTS,

vs.

THE IOWA STATE BOARD OF ASSESSMENT AND REVIEW

APPEAL FROM THE SUPREME COURT OF THE STATE OF IOWA

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[fol. 2]

IN SUPREME COURT OF IOWA.

HENRY O. HALE and ELIZABET- C. HALE, Appellants,

v.

IOWA STATE BOARD OF ASSESSMENT AND REVIEW, Appellee

ORDER SETTLING RECORD—Filed March 15, 1937

It is hereby Ordered that the record hereto attached, numbered from page 1 to 93 inclusive, contains all the opinions, orders, records and proceedings in this cause which are necessary and material upon the review hereof by the Supreme Court of the United States, and shall be certified by the Clerk of this Court as such, and be by him transmitted to the Clerk of the Supreme Court of the United States.

Dated at Des Moines, Iowa, this 15th day of March, 1937.

Paul W. Richards, Chief Justice of the Supreme Court of Iowa.

[fol. 3] IN SUPREME COURT OF IOWA

[Title omitted]

STIPULATION AS TO RECORD—Filed March 15, 1937

It is hereby stipulated and agreed by the attorneys for the parties that the Record hereto attached, consisting of ninety-theree pages numbered consecutively from one (1) to ninety-three (93) inclusive and including this Stipulation as Page 3, contains all the opinions, orders, records, and proceedings in this action that are necessary and material upon the review of such opinion and order by the Supreme Court of the United States, and may be certified by the Clerk of the Supreme Court of Iowa as the complete record of such proceedings and shall constitute full compliance with all requirements.

Wm. L. Hassett, Alan Loth, Attorneys for Appellants. John H. Mitchell, Clair E. Hamilton, Attorneys for Appellee.

[fol. 4] IN SUPREME COURT OF IOWA

[Title omitted]

PETITION FOR ORDER ALLOWING APPEAL AND APPROVING BOND —Filed February 23, 1937

The appellants, Henry O. Hale and Elizabeth C. Hale, considering themselves aggrieved by the final decision of the Supreme Court of Iowa entered in this cause on the 19th day of January, 1937, pray that an appeal be allowed them therefrom to the Supreme Court of the United States; and that all proceedings in this court, save such as are necessary to complete said appeal, be stayed, and that the bond tendered herewith be approved as an appeal bond and as a supersedeas bond and as a bond for costs.

The appellants also file herewith their assignments of error and their statement showing that the Supreme Court of the United States has jurisdiction of such appeal.

Henry O. Hale and Elizabeth C. Hale, by Alan Loth, Wm. L. Hassett, Their Attorneys.

[File endorsement omitted.]

[fol. 5] IN SUPREME COURT OF IOWA

[Title omitted]

ASSIGNMENTS OF ERROR—Filed February 23, 1937

Appellants assign as errors the following:

1. The Supreme Court of Iowa erred in finally deciding that the Iowa Personal Income Tax Law (1935 Code, sec. 6943-f-1 to 6943-f-27), construed to impose a tax on appellants' personal income from their tax-exempt bonds issued by Iowa and its municipalities prior to the passage of said Law, did not thereby impair the obligation of the contracts making said bonds exempt from all taxation, and so violate, as to these appellants, Article I, section 10, of the Constitution of the United States forbidding a state to pass any law impairing the obligation of a contract.

2. The Supreme Court of Iowa erred in finally deciding that said Iowa Personal Income Tax Law, construed to lay a tax on appellants' personal income from their bonds

issued as tax-exempt by Iowa and its municipalities prior to the passage of said law, did not impose such a tax on said bonds as would violate the pre-existing contracts making them exempt from all taxation, and therefore was valid despite Article I, section 10, which forbids a state to pass any law impairing the obligation of a contract.

3. The Supreme Court of Iowa erred in refusing to hold that the Iowa Personal Income Tax Law aforesaid violated Article I, section 10, of the Constitution of the United [fol. 6] States as to these appellants, by imposing a tax on their personal income derived solely from the ownership of tax-exempt bonds issued, prior to the passage of said Law, by Iowa and its municipalities as exempt from all taxation, thereby impairing the obligation of a contract and being unenforceable against these appellants in respect of the tax thereby imposed on such personal income.

For which errors appellants pray that the final judgment of the Supreme Court of Iowa herein be reversed, and that they have judgment for their costs.

Alan Loth, Wm. L. Hassett, Attorneys for Appellants.

[fols. 7-37] In Supreme Court of Iowa

[Title omitted]

Order Allowing Appeal and Approving Bond—Filed February 23, 1937

On this 23rd day of February, 1937, upon the appellants' petition for an allowance of their appeal to the Supreme Court of the United States from the final decision and judgment of this Court entered herein on January 19, 1937, and for the approval of the bond tendered therewith, it is now

Ordered that said appeal be and is hereby allowed, and the bond aforesaid is hereby approved, and that all proceedings in this Court, save such as are proper to complete said appeal, are stayed pending the outcome thereof.

Paul W. Richards, Chief Justice of the Supreme Court of Iowa.

[fol. 38] Citation, in usual form, showing service on Clair E. Hamilton, filed February 26, 1937, omitted in printing.

[fol. 39] IN SUPREME COURT OF IOWA

[Title omitted]

PRÆCIPE FOR TRANSCRIPT OF RECORD—Filed February 26, 1937

To Honorable B. W. Garrett, Clerk of the Supreme Court of Iowa:

Please include the following in the transcript of the record to be transmitted to the Supreme Court of the United States pursuant to the allowance of appeal thereto:

1. On all papers filed in your office, show date of such filing.

2. The Abstract of the Record, filed in your office, which shows, inter alia:

(a) Plaintiffs' Petition, including exhibits thereto;

(b) Plaintiffs' Notice of Appeal (to the District Court) from the Order of the State Board of Assessment and Review;

(c) Answer of Defendant;

(d) Reply of Plaintiffs;

(e) The stipulations and evidence on the trial;

(f) The opinion of the trial court, embodying its judgment;

(g) The Notice of Appeal to the Supreme Court of Iowa.

3. The following portion of Appellants' Brief in the Iowa Supreme Court specifying the points relied on for reversal: Page 5, beginning with the caption "Division I" and ending with the sentence immediately preceding the subhead "Proposition 1" on page 6.

[fol. 40] 4. The Opinion of the Iowa Supreme Court.

5. The judgment of affirmance entered in the Iowa Supreme Court.

6. Petition for Appeal to the Supreme Court of the United States.

7. Assignments of Errors filed with said Petition for Appeal.

8. Order allowing said appeal and approving bond thereon.

9. Statement as to Jurisdiction of the Supreme Court of the United States, filed with said Petition for Appeal.

10. Acknowledgment by counsel for appellee of service of copies of said Petition for Appeal, Assignments of Error and Statement.
11. Citation and acknowledgment of service thereof.
12. This Præcipe for Transcript.
13. Any stipulations or orders settling the record.
14. Your own certificate to the record.

Alan Loth, Wm. L. Hassett, Attorneys for Appellants.

Due, timely and proper service of the foregoing Præcipe and receipt of copy thereof is acknowledged, at Winterset, Iowa, this 25th day of February, 1937.

Iowa State Board of Assessment and Review, by Clair E. Hamilton, Special Assistant Attorney General of Iowa, Its Attorney.

[fol. 41] [File endorsement omitted]

IN SUPREME COURT OF IOWA, MAY TERM, 1936

In Equity

11—43610

HENRY O. HALE and ELIZABETH C. HALE, Appellants,

vs.

IOWA STATE BOARD OF ASSESSMENT AND REVIEW, Appellee

Appeal from Webster County District Court, Hon. T. G. Garfield, Judge

Alan Loth, of Fort Dodge, and William L. Hassett, of Des Moines, Attorneys for Appellants.

Clair E. Hamilton, Special Assistant Attorney General, of Winterset, Attorney for Appellee.

Abstract of Record from District Court of Webster County—Filed April 27, 1936

[fol. 42] On February 24, 1936, plaintiffs filed their verified

PETITION IN EQUITY

which, as amended, is as follows:

1. That plaintiffs are husband and wife, residing at Fort Dodge, Webster County, Iowa; and are and have always been residents and citizens of Iowa.

2. That they made due return as to their income for the year 1935, a true copy of which is attached hereto, marked Exhibit "A" and made part hereof; and said return was filed with the defendant Board in January, 1936.

3. That during the year 1935, they jointly owned the bonds hereafter referred to and which are described in said return and also in paragraph 3 of Exhibit "C" hereof; and that they received interest during said year upon said bonds in the total aggregate sum of $36,893.75, as itemized in said Exhibit "A".

4. That all of said interest accrued and was paid to them in accordance with the provisions of said bonds and solely because of their ownership of said bonds.

5. That all of said bonds were issued after April 16, 1909, on which date the statute of Iowa then known as Section 1304 of the Iowa Code of 1907 providing that "The following classes of property are not to be taxed" was amended by the 33rd General Assembly of Iowa so as to add thereto the following: "municipal, school and drainage bonds hereafter issued," which clause was later amended by adding thereto the phrase "by any municipality, school district, drainage district or county within the state of Iowa"; so that, prior to the issuance of said bonds, the statutes of the state of Iowa provided as follows:

"The following classes of property are not to be taxed: * * * municipal, school and drainage bonds hereafter [fol. 43] issued by any municipality, school district, drainage district or county within the state of Iowa."

And that the Road Bonds above referred to were all issued under, and after the passage of, the Iowa statute now known as Section 4753-a-13 of the Iowa Code, which provides that:

"Bonds and Road Certificates (whether issued in anticipation of special assessments or in anticipation of annual allotments of the primary road fund) shall not be taxed,"

and were such bonds as are there described.

And that the $1,000 bond of the State of Iowa denominated "Soldiers' Bonus Bond" was issued pursuant to Chapter 332 of the acts of the 39th General Assembly, Sub-

section 10, of which provides:

"Exemptions. All payments and allowances made under this act shall be exempt from taxation * * * and all bonds issued hereunder shall be exempt from taxation."

6. That the statutes relative to all bonds such as are herein described, which existed at the time of their issue, provided that they should not be issued or sold for less than par and accrued interest, said statutes being now known respectively as Sections 4407, 1175, 5278 and 4753-a-13 of the Code of Iowa.

7. That each of said bonds is negotiable in form, being payable to bearer; and each of said bonds was issued by the state, district or county emitting the same for sale and circulation in Iowa, and was sold by such issuer for an amount equal to or greater than par and accrued interest; and that each of said bonds was acquired by plaintiffs either [fol. 44] direct from the issuer thereof, or from the original purchaser from such issuer.

8. That said bonds are all of the kind described and referred to by the respective statutes referred to in paragraph 5 hereof.

9. That about February 8, 1936, acting upon the data contained in said return, Exhibit "A", defendant undertook to assess a tax of $1,387.24 upon the 1935 income of these appellants because of, and based upon said "Interest on State, Road and Municipal Bonds", by giving a notice of such assessment to these plaintiffs, of which a copy is attached hereto, marked Exhibit "B", and made part hereof.

10. That thereupon these plaintiffs filed with said Board an appeal for the revision and cancellation of such tax, of which a copy is attached hereto, marked Exhibit "C", and made part hereof; and that on February 13, 1936, a hearing was had before said Board upon said appeal, and a ruling was then and there entered denying the appeal and confirming the attempted assessment of said tax, a copy of which ruling is attached hereto, marked Exhibit "D", and made part hereof.

11. That thereupon and within the time permitted by law, a notice of appeal to this court was duly served as provided by law, and this petition is filed pursuant to such

notice, which is likewise filed herein, together with the bond required by law.

12. That there is no warrant or authority in any law for the assessment or imposition of the alleged tax herein appealed from. That Chapter 329-F1 of the Iowa Code, properly construed, does not impose or authorize any tax upon or because of interest received from any of such bonds; that such interest is not "taxable" income such as is referred to in said statute; that, there being no law authorizing such assessment, [fol. 45] it is unwarranted, illegal and void, and the Board is without power to assess or collect such tax.

13. That said statute does not repeal nor impair the policy expressed by the statutes referred to in paragraphs 5 and 6 of this petition; and that said statutes forbid the assessment here made.

14. That upon the issuance of, and payment of, each of said bonds, a contract arose between the issuer and the purchaser; that the aforesiad statutory immunity from taxation applicable to such bond, became part of such contract; and that the holder of each of said bonds, after paying for same, held a contract that such bond should not be taxed and should be immune from taxation. That accordingly, the assessment now attempted by defendant impairs the obligation of plaintiffs' contracts and violates the same, in violation of the rights of these plaintiffs, as holders of said bonds, which are guaranteed to them by Article I, Section 10, of the Constitution of the United States, and by Article I, Section 21, of the Iowa Constitution.

15. That Chapter 329-F1 of the Iowa Code, if construed to authorize such assessment is, in that respect, unconstitutional and void and violates the constitutional and contractual rights of these plaintiffs which are last above referred to.

16. That the assessment aforesaid is in essence, operation and effect, and in form as well as in substance, an attempt to tax the bonds contrary to the respective statutes referred to in paragraph 5 hereof, and to plaintiffs' contractual and constitutional rights heretofore mentioned. That the assessment is upon interest received wholly and directly on said bonds, paid direct to these plaintiffs from the issuers of said bonds, and upon such interest in the very form in

which it was received; that, as shown by said return, plaintiffs had no other income during 1935 upon which any tax [fol. 46] was or could be claimed; that plaintiffs, as holders of said bonds, had the absolute and inviolable right to receive such interest as was paid them thereon, which right was not and could not be made subject to any excise or privilege tax, nor does Chapter 329-F1 of the Iowa Code impose or provide for any excise or privilege tax upon the receipt of such income as is here involved, nor could it constitutionally do so without impairing the obligation of plaintiffs' contracts, and depriving them of their property without due process of law and without compensation, in violation of the 14th Amendment to the Constitution of the United States, and of the Constitution of Iowa.

Wherefore plaintiffs pray for a decree which shall determine that they had no taxable income for the year 1935, and setting aside the pretended assessment herein appealed from, and decreeing that the interest from each and all of said bonds is exempt from such tax, and that defendant is without power or authority to impose any tax herein, and for such other and further relief as may be equitable herein, and for judgment for costs.

(Duly signed and verified.)

Attached to the petition are the following exhibits:

EXHIBIT "A" TO PETITION

Income Tax Return for 1935, the material parts of which are as follows:

Describe business, profession or occupation: no business; farm owner and investor.

3. Interest from all sources, including exempt interest $1,322.69. In addition to the interest reported, taxpayers held bonds during 1935 and received interest therefrom as follows:

[fol. 47]

	Principal	Interest
State of Iowa, Soldiers Bonus Bond	$1,000	$45.00
Iowa School District Bonds	666,900	32,648.75
Road Bonds of Iowa Counties	82,000	4,072.50
County Bonds Issued by Iowa Counties	3,000	127.50
Totals	$752,900	$36,893.75

All the foregoing bonds were issued and held long prior to March 8, 1934, except the following (listing road and school bonds in the principal sum of $27,000 which yielded interest of $1,187.50). Taxpayers claim that the interest on each of said bonds is not taxable; that these bonds were all issued under statutes exempting them from taxation; that the Iowa Income Tax Act does not impose a tax on said items of interest; that, if it did, it would, as to the bonds issued prior to its passage, be unconstitutional. Taxpayers accordingly refuse to pay any tax on said items of interest.

6. Income from rents and Royalties. Deficit	$5,031.16
9. Total income in items 1 to 8: deficit or loss in taxable income	$3,708.47
Deductions (Itemized in original exhibit for interest, taxes, contributions to charities, etc.)	3,120.50
Other deductions authorized by law: see statement above relative to interest claimed as exempt.	
15. Net Income: Deficit	$6,828.97

[fol. 48] EXHIBIT "B" TO PETITION

is a "Notice of Assessment" by defendant to plaintiffs dated February 8, 1936, stating that the Income Tax Division of defendant has charged plaintiffs with an individual income tax of $1,327.24. Computation of the tax and the elements on which it is based is included in this notice, as follows:

1. Net income disclosed by return: deficit		$6,828.97
As corrected		30,064.78
Net adjustment		$36,893.75
Unallowable deductions and additional income:		
Interest from State, Bond and Municipal Bonds	$36,893.75	
2. Tax as corrected. Schedule 1	$30,064.78	
Tax on $30,064.78	$1,403.24	
Less Personal exemption and credit for dependents	16.00	
Total Tax assessable	$1,384.24	

and said exhibit requires remittance thereof within 10 days, and states that an appeal may be taken to the defendant Board for a revision of this tax within 90 days. Signed by Chairman of defendant Board.

EXHIBIT "C" TO PETITION

is plaintiffs' Application for Abatement of Income Tax and Appeal for Revision of Tax, filed with defendant Board with respect to the tax stated in Exhibit "B", and within the time allowed thereby, stating that the assessment is against interest from bonds of the State of Iowa, its counties, [fol. 49] school districts and municipalities, and Iowa Primary Road Bonds, and is unwarranted, and illegal, on the grounds specified (which are the same as those specified in the petition in equity in this action and are not therefore repeated here). This exhibit also contains a list of the bonds and interest involved, in more detail than in Exhibit "B", as follows:

(a) School Bonds issued prior to March 8, 1934, and since April 16, 1909, by various school districts in Iowa, of total aggregate par value of $649,900. (b) School Bonds as above, issued after March 8, 1934, of a total aggregate par value of $17,000; (c) County Bonds issued by Pocahontas County; Iowa, prior to March 8, 1934, par value $3,000. (d) Iowa Primary Road Bonds issued by Iowa counties prior to March 8, 1934, and after April 16, 1909, in anticipation of the collection and allotment of Primary Road Funds, pursuant to Sections 4723 and 4723-2-1e of the Iowa Code of the total par value of $82,000; (e) Soldiers' Bonus Bond issued by the State of Iowa prior to March 8, 1934, of the face value of $1,000.

EXHIBIT "D" TO PETITION

Order of defendant Board on the claim made in Exhibit "C" dated February 13, 1936, reciting appearances of taxpayers by counsel, a hearing by the board, and that the assessment of a tax of $1,387.24 is correct, legal and should be affirmed, and overruling the application of the taxpayers for its revision and abatement. Duly signed by chairman of Board and shows all members of the Board concurring.

On February 24, 1936, plaintiffs also filed their

NOTICE OF APPEAL

from the order of the Board of February 13, 1936 (being [fol. 50] Exhibit "D" above) in due form, directed to defendants, reciting an appeal from said order to the district court, the filing of a bond and petition in said court, and requiring defendants to appear in said court and answer on the second day of the March, 1936, term of said court which convenes and will be held at Fort Dodge, Iowa, March 9, 1936. Duly signed. Shows due and timely service on the defendant Board.

On March 7, 1936, the defendants filed

ANSWER OF IOWA STATE BOARD OF ASSESSMENT AND REVIEW

1. Defendant denies each and every allegation contained in plaintiffs' petition except such as are herein expressly admitted.

2. Defendant admits Paragraph 1, 3, and 4 of the petition; and admits paragraph 2 thereof except the statement as to the return of income filed by plaintiffs, and denies that said return was a correct return as required by the income tax laws of Iowa.

3. As to whether the bonds were issued after the dates alleged in paragraph 5, defendant has neither knowledge nor information, and therefore denies same.

4. Admits the allegations of Paragraphs 6 and 7 of the plaintiffs' petition.

5. Answering Paragraph 8 the defendant denies the allegations thereof for the reason that it has no information concerning the correctness thereof.

6. The defendant also admits the allegations contained in Paragraphs 9, 10 and 11 of the plaintiff's petition.

7. The defendant further alleges that it denies the allegations of Paragraphs 12, 13, 14, 15 and 16. It further alleges [fol. 51] that the tax provided for in Chapter 329-F1 in the Code of 1935 is not a property tax but an excise tax and

that the exemption granted in Section 1304 of the Code of 1907, now appearing as Section 6944 (2), applies only to property tax and has no application to an excise tax. That the said additional assessment made by the State Board of Assessment and Review as alleged in Paragraph 9 of the plaintiffs' petition was not an assessment of general property taxes but an assessment under the provisions of Chapter 329-F1 of the Code of 1935, which provides for an excise tax. That for that reason the acts of the Board of Assessment and Review in making said additional assessment does not impair the obligation of an existing contract nor does it violate in any way Article I, Section 10, Constitution of the United States, and Article I, Section 21, of the Constitution of Iowa; nor does the action of the Board of Assessment and Review or the provisions of Chapter 329-F1 deprive the plaintiffs of their property without due process of law in violation of the Fourteenth Amendment to the Constitution of the United States or the provisions of the Constitution of Iowa.

Wherefore, defendant prays the appeal be dismissed and for a decree affirming and upholding its action and declaring the additional assessment valid and for general equitable relief including costs. (Duly signed and verified.)

On March 19, 1936, plaintiffs filed their

REPLY

1. They deny each and every allegation contained in said answer except such as admit allegations contained in the plaintiffs' petition.

[fol. 52] 2. As to paragraph 7 of said answer, and in addition to the foregoing denial, they deny that Chapter 329-F1 is an excise tax; they deny that Section 6944 of the Code has no application to an excise tax; they deny that the additional assessments made by defendants assesses an excise tax. They allege that the assessment here involved is essentially an attempt to impose a tax on the bonds, no matter by what name it my be called. They allege that the exemption specified in Section 6944 of the Code applies to such tax as is here claimed, regardless of whether such tax be an excise tax or not. And they allege, separately as to each

sentence of paragraph 7 of said answer other than the first, that said paragraph contains nothing more than a conclusion of law and argument of counsel, and states no issuable or ultimate fact, and that accordingly all of said paragraph 7 after the first sentence is improper, and they except thereto and move to strike the same for the foregoing reasons.' (Duly signed and verified.)

Thereafter on March 23, 1936, the cause came on for trial and was tried to the court in equity, and the following proceedings were had and duly made of record:

STIPULATION AS TO CERTAIN FACTS

The parties in open court stipulated and agreed as follows:

(2) That during the month of January, 1936, the plaintiffs filed with the Iowa State Board of Assessment and Review a joint income tax return (as husband and wife), and that Exhibit "A" attached to the Petition is a true copy thereof.

(3) That during the year 1935, they, the plaintiffs, did jointly own the bonds described in their return (Exhibit "A" attached to their Petition in this case) which bonds are also described in Exhibit "C" attached to the Petition [fol. 53] in this case. And that during said year 1935 they received interest upon the said bonds in the total aggregate sum of $36,893.75, which interest and the sources thereof is correctly itemized in the said Exhibit "A".

(4) That all of said interest accrued and was paid to the plaintiffs during the year of 1935 and solely because of their ownership of said bonds.

(5) That all of said bonds (except the Iowa Soldiers Bonus Bond) were issued after the enactment of what now appears to be Section 6944 (5) of the Code of Iowa for 1935. That the Soldiers Bonus Bond was issued pursuant to the provisions of Chapter 332 of the Acts of the Thirty-ninth General Assembly. That the Primary Road Bonds were bonds issued by the various counties of the State of Iowa pursuant to what now appears as Section 4753-A13 of the

Code of 1935, and were issued after April 19, 1919, the date on which Chapter 237 of the Acts of the Thirty-eight-General Assembly became a part of the law of this state.

(6) That on or about the 8th day of February, 1936, the defendant Board of Assessment and Review did levy an additional assessment upon and against the plaintiffs in accordance with the notice of assessment, copy of which is attached to the Petition in this case and marked Exhibit "B", and that thereafter the plaintiffs did make application to the defendant for abatement of such additional tax and did prosecute their appeal for revision of the same, all in accordance with Exhibit "C" attached to the Petition in this case.

(7) That the application for abatement of tax and appeal for revision of same referred to in the last preceding paragraph, was duly considered by the defendant, which did, thereafter and on or about the 13th day of February, 1936, make and enter its findings denying the said application for [fols. 54-57] abatement and denying the application for revision all in accordance with Exhibit "D" attached to the Petition in this case.

(8) It is conceded by the parties hereto that in so far as the notice and order of additional assessment, application for abatement of the tax, and appeal for revision of the tax, findings of the Board of Assessment and Review, and notice of appeal to this court are concerned, all of said proceedings have been had and taken in due time and in the manner provided by law and that this court has jurisdiction of the parties and the subject matter of this cause.

[fol. 58] Both parties rest.

Evidence closed.

[fols. 59-67] Findings, Judgment and Decree, filed April 22, 1936, omitted in printing as it is incorporated verbatim in the opinion of Supreme Court of Iowa.

[fol. 68] NOTICE OF APPEAL

Thereafter, on April 24, 1936, plaintiffs filed their Notice of Appeal from the foregoing Findings, Judgment and De-

cree, in proper form, directed to the Iowa State Board of Assessment and Review, and its attorney of record in the lower court, stating that the appeal is taken from said findings, judgment and decree to the Supreme Court of Iowa for the May, 1936, Term thereof, duly signed by counsel for plaintiffs.

[fol. 69] IN SUPREME COURT OF IOWA

[Title omitted]

EXCERPTS FROM APPELLANTS' BRIEF AND ARGUMENT—Filed June 19, 1936

"The court erred in adjudging that the asessment be affirmed and the appeal therefrom dismissed, and that the income tax law does not 'result in the impairment of any constitutional obligation in violation of the State or Federal Constitutions.' * * *

"This was erroneous because the state may not, directly, or through its subdivisions, sell a bond under a statute which provides it shall not be taxed, and later impose a tax on the interest received by the individual holding such bond as a mere incident of his ownership. Such tax impairs the obligation of the contract, in violation of Section 10 of Article I of the Federal Constitution because:

"1. The statutory exemption created a contract with the bondholders which cannot be impaired by a later tax;

"2. A tax on individual income derived solely from the ownership of tax-exempt securities violates the exemption, being essentially a tax on the bonds or their ownership;

"3. The tax on this income cannot be a privilege tax so as to escape the exemption, because plaintiffs exercise no privilege to which the tax can be ascribed. It is therefore a tax imposed solely because of their ownership of the bonds; and that is a property tax within the exemption.

"4. The authorities relied on by the trial court do not support his decisions. They either apply to entirely different questions, or else support our claims.

"5. The exemption cannot be construed as though it said that the bonds shall be 'exempt from all property taxes

except income taxes'; because they contain no such exception, and no rule of construction permits reading it into them.

These specifications will be separately argued under the propositions which follow."

[fol. 70] IN SUPREME COURT OF IOWA

43610

HENRY O. HALE and ELIZABETH C. HALE, Appellants,

vs.

IOWA STATE BOARD OF ASSESSMENT AND REVIEW, Appellee

Appeal from Webster County District Court

Hon. T. G. Garfield, Judge

OPINION—Filed January 19, 1937

Suit in equity to annul an Iowa income tax assessment against the plaintiffs, the income consisting solely of interest received on tax exempt municipal securities. It is the claim of plaintiffs that the assessment is in reality upon the bonds themselves and therefore impairs the contractual immunity from taxation which inheres in the bonds and is violative of Article I, Section 10 of the Federal Constitution, and further that the Iowa Income Tax Act does not authorize assessing such interest as taxable income. By way of defense it is alleged and claimed by the appellee that the Iowa Income Tax Act is a general income tax law and includes all income not specifically exempted by the act itself, and that interest on tax exempt municipal securities such as those owned by the plaintiff are not exempted by the provisions of the income tax act and therefore such interest, along with all other taxable income is subject to the tax, and that this is not a property tax but an excise tax and not a tax on the bonds themselves, and that the general tax exemption statutes have reference to direct property tax and not to an excise tax, and that therefore the income tax act does authorize the imposition of said [fol. 71] tax upon the interest received by the plaintiffs

from the municipal securities owned by them, and that the tax is a valid exercise of the taxing power of the state and does not violate any constitutional provision, and the imposition of said tax does not impair any contractual immunity under the constitution. The trial court denied the plaintiffs' petition and upheld the tax and plaintiffs have appealed.

Affirmed.

Alan Loth, of Fort Dodge, and William L. Hassett, of Des Moines, Attorneys for Appellants.

Clair E. Hamilton, Special Assistant Attorney General, of Winterset, Attorney for Appellee.

HAMILTON, J:

The facts are not in dispute and briefly stated are as follows:

During the month of January, 1936, plaintiffs, who were husband and wife, filed with the Iowa State Board of Assessment and Review a joint income tax return, in which they reported that they were engaged in no business but were farm owners and investors. They reported interest from all sources, including exempt interest in the sum of $1322.69. In the report they state that in addition to the interest reported they held bonds during 1935 and received interest therefrom as follows:

[fol. 72]

	Principal	Interest
State of Iowa, Soldiers Bonus bonds	$1000.00	$45.00
Iowa School District bonds	666,900.00	32648.75
Road Bonds of Iowa Counties	82,000.00	4072.50
County Bonds	3,000.00	127.50
	$752,900.00	$36893.75

Under the heading of "Income from rents and royalties" they report a deficit of $5031.16. From this they deduct the $1322.69 leaving a deficit or loss in taxable income of $3708.47. They also report deductions for interest, taxes, contribution to charities, etc. of $3120.50 or a net income deficit of $6828.97. They decline to pay the tax on the

$36,893.75 interest received from the municipal securities above listed, claiming that this interest was received on tax exempt bonds, and that the Iowa Income Tax Act does not impose a tax on said items of interest, and that if it did it would as to the bonds issued prior to its passage be unconstitutional, and they accordingly refuse to pay any tax upon said items of interest. The Iowa State Board of Assessment and Review corrected said return by charging the plaintiffs with an additional income tax because of the interest received on said bonds, making the amount of the net income $30,064.78 (after allowing the deficit of $6828.97 as disclosed by the plaintiffs' tax report) tax upon which would be $1403.24, less personal exemption and credit for dependents of $16.00, leaving a total tax imposed as corrected of $1384.24, and under date of February 8, 1936, gave the plaintiffs notice of assessment in accordance with the statute. In due time the plaintiffs made application for abatement of said tax and appealed for revision of the tax to the board, setting up in said application the same specifications as are contained in their petition in this action. There was a hearing before the board, affirming the tax as corrected and overruling the application of the plaintiffs [fol. 73] for revision and abatement of the tax. In due time and in accordance with the statutory provisions plaintiffs appealed from said order to the district court, and it is conceded that in all respects the statutory procedure has been complied with, both in imposing the tax and in raising the legal questions presented to this court.

Appellants emphasize very strongly in their argument that the interest received, being so received solely because of the incident of ownership of the bonds, could not be considered a gain or profit derived from any business or profession, and hence would not fall under the general classification of excise tax known and referred to as a tax on the privielege of transacting a business or occupation, and since the income was received solely as an incident to ownership and because of their ownership of said bonds, the appellants go one step farther and insist that this assessment was made solely because of the ownership of said bonds and therefore is a tax upon the bonds themselves.

We do not think it can be truthfully said that these plaintiffs were engaged in no business, in the broadest sense of that term. They list themselves as farm owners and in-

vestors. Their business therefore must be held to be that of looking after their farming interest and in vesting their capital. The extent of their farm business is only revealed by the deficit in income from rents and royalties listed in their report as $5031.16. This deficit no doubt is carried over from a separate farm income report, showing this deficit. Their ownership of other securities in addition to the municipal bonds, interest from which they claim is not taxable, is only shown by the amount of interest from all sources in the sum of $1322.69. The fact that they had most of their wealth invested in tax exempt securities in no way detracts from their status as investors of capital. They might be carrying on an investment business of several million dollars and own nothing but tax exempt securities and still contend that they had no business. Their capital in- [fol. 74] vestments in these tax exempt securities amounted to three quarters of a million dollars and they realized a gain or profit by way of interest on their investment of $36,-893.75, and while they were not engaged in the business of farming in the sense that they operated the farm or farms owned by them, but in the sense that the farms represented a part of their investments of their capital, labor, service and energy expended in an endeavor to make the farms pay or realize returns on such investment, they might well be said to be also engaged in the business of farming.

The case was ably presented by counsel representing the respective parties. The trial court took time to consider the facts and the law presented and rendered his decision in writing, which shows a careful analysis of the entire matter, and which we are incorporating at length in this opinion, and which reads as follows:

"The case presents the question whether income from tax exempt securities is subject to the state income tax.

"Plaintiffs argue that the Income Tax Statutes do not authorize the tax sought to be enforced. It seems clear from a reading of the Income Tax law that it is the expressed intent of the Legislature that this income is taxable. Code Section 6943-f7 provides: 'The term "net income" means the gross income of the taxpayer less the deductions allowed by this division.' The following section defines 'gross income' as 'gains, profits and incomes derived * * * from interest, rent, dividends, securities, or * * *

from any source whatever and in whatever form paid.' Par. 2 of the same section (6943-f8) contains an enumeration of the items exempt from the operation of the income tax, among which is: 'd. Interest upon the obligations of the United States or its possessions, agencies, or instrumentalities, which is or shall be exempt from state taxation [fol. 75] by federal law.' The statutory definition of income is clearly broad enough to include the income in question. The statute having exempted several items from the effect of the tax (including interest on obligations of the Federal government) it must be presumed that the legislature would have included interest from municipal bonds among the exemptions, if such had been its intent. As authority for this conclusion see, Willcuts v. Bunn, 75 L. ed. (U. S.) 304 at 306, where the Supreme Court places an analogous interpretation on the Federal Act. And, also in point on this question is appeal of Van Dyke, 259 N. W. (Wis.), 700 at 704.

"Does the operation of the tax on the income derived from the bonds involved in this case result in the impairment of any contractual obligation in violation of the State or Federal Constitutions?

"The conclusion above reached on the question of construction of the Income Tax Statutes leads to the result that as to the bonds issued after the Income Tax law went into effect (of the face value of $27,000) the interest therefrom is subject to the tax imposed by the defendant.

"All of the securities here involved, other than the $27,000 above referred to, were issued before the effective date of the Income Tax law. All the bonds were issued pursuant to statutory authority. The exemption statute applicable to most of the bonds is Code Section 6944, the first section in Chapter 330, which chapter is entitled: 'Property Exempt and Taxable.' The section reads: 'The following classes of property shall not be taxed: * * * 5. Public securities. Bonds or certificates issued by any municipality, school district, drainage or levee district * * *, or County within the State of Iowa * * *. 22. Soldiers bonus bonds.' Code Section 6953 provides: 'What taxable. All [fol. 76] other property, real or personal, is subject to taxation in the manner prescribed.' Part of the bonds in question were exempted also by Code Section 4753-a13, reading as follows: 'Bonds and road certificates * * * shall not be

taxed.' The exemption provided by Section 4753-a13 surely is not more broad than the exemption stated in Section 6944.

"Plaintiffs contend that the foregoing exemption constitutes a contractual obligation and that it is broad enough to exempt not only the bonds but also the income derived from the bonds from the income tax. It will be assumed that the exemption is in the nature of a contractual obligation which cannot be impaired. Perhaps it could be contended with some force by the defendant that the exemption is not contractual but merely declaratory of a legislative policy which is not irrevocable. On this point, see Wisc. & M. R. Co. v. Powers, 48 L. Ed. (U. S.) 229. The serious question is whether the statutory exemption of the bonds, conceding it to be contractual, is broad enough to include exemption of the income from the securities from the income tax. Defendant contends that the statutory exemption applies only to general property taxation and that the income tax is not a property tax but is an excise tax. It is undoubtedly the general rule that an exemption from property tax does not constitute an exemption from an excise tax. In order to sustain the tax in question it is not necessary fully to adopt the defendant's contentions. The tax is enforceable if the statutory exemption of the bonds is too narrow to exempt the income from the operation of the income tax. Although the matter is not wholly free from doubt, it seems fairly clear that the exemption is not so broad as plaintiffs contend and that the income tax is enforceable. Following [fol. 77] are the principal reasons and some of the authorities to be given in support of this conclusion.

" 'Taxation is the rule and exemption the exception, and therefore, strict construction of the statute (now Code Section 6944) under which the exemption is claimed is the rule.' City of Sioux City v. School District, 55 Iowa, 150 at 152. 'Grants of immunity from taxation, in derogation of a sovereign power of the State, are strictly construed.' Pacific Co. v. Johnson, 285 U. S. 480 at 491. The authorities make it clear that the statutory exemption must be given a strict and somewhat narrow construction as distinguished from a liberal and broad construction. It is also clear that every presumption is indulged in favor of the constitutionality of the income tax statute; that it must be upheld unless its invalidity is manifest beyond a reasonable doubt. Code Section 6944 must, if fairly possible, be so construed as to save the constitutionality of the income tax law.

"The exemption statute itself—construed in the light of the foregoing rules—seems to be applicable only to property taxation. The wording of the section (6944) itself so indicates. And see Code Section 6953. The Iowa Court has so construed this same section in cases where it was sought to exempt public property from special assessments. Sioux City v. School District, 55 Iowa 150; E. & W. Construction Co. v. Jasper County, 117 Iowa, 365. And in a case where it was sought to have exempted property owned by an alleged charitable institution from a business or license tax the same construction was placed on the same statute. Iowa Mut. Tornado Ins. Ass'n. v. Gilbertson, 129 Iowa, 658. In State v. City of Des Moines, No. 43016, decided March 17, 1936, it is held that the same statute (exempting property [fol. 78] of a city from taxation) does not exempt a city from paying the state gasoline tax on gasoline owned and used by the city, the court saying that the gasoline tax is not a property tax but an excise tax. This last decision is in line with numerous decisions from many different jurisdictions under strikingly similar statutory provisions. Some of the many authorities are cited in the City of Des Moines case.

"There is much respectable authority in other jurisdictions sustaining the view that a similar statutory exemption of municipal bonds from taxation refers only to general property taxes and not to such a tax as the income tax. Appeal of Van Dyke, 259 N. W. (Wisc.), 700, so holds. People v. Gilchrist, 67 L. Ed. (U. S.) 883, recognizes the doctrine for which defendant contends by affirming a decision of the New York Court of Appeals in the following words (quoting from page 893):

"'Considering that only the principal of mortgages was taxed when the law was passed, and that in those days no one thought of an income tax; *that any contract of exemption must be shown to have been indisputably within the intention of the legislature;* that it is difficult to believe that the legislature meant to barter away all its powers to meet future exigencies for the mere payment of a mortgage recording tax; and that a tax upon the individual, measured by net income, might be regarded as one step removed from a tax on the capital from which the income was derived (Wm. E. Peck & Co. v. Lowe, 247 U. S. 165). It (N. Y. Ct.

of Appeals) held that there was no promise that the present [fol. 79] (income) tax should not be imposed.'

"The validity of state income tax statutes has not generally been called into question in the courts under constitutional provisions requiring that all property shall be taxed uniformly according to its true value. Apparently most of the states have constitutional provisions of this character. Although there are a few exceptions, it has most generally been held in most jurisdictions that such constitutional provisions apply only to property taxation; that income is not 'property' within the law of taxation; that an income tax is not a property tax but falls more nearly within the category of excise taxes. Some of the many authorities so holding are O'Connell v. Board, 25 Pac. 2nd. (Mont.), 114; Diefendorf v. Gallet, 10 Pac. 2nd. (Idaho), 307; Maxwell v. Mfg. Co., 168 S. E. (N. C.), 397; Bacon v. Ranson, 56 S. W. 2nd. (Missouri), 786; State v. Nichols, 265 N. W. (N. D.), 859.

"In Black on Income and Other Federal Taxes (3rd Ed., Sec. 44) it is said:

" 'The term "property" as used in reference to taxation means the corpus of an estate or investment as distinguished from the annual gain or revenue from it.'

"It seems unnecessary to determine the question whether an income tax is, strictly speaking, an excise tax. The Iowa Income Tax Act, in terms, imposes a tax 'upon every resident of the state, which tax shall be levied, collected and paid annually upon and with respect to his entire taxable income, etc.' (Code 6943-f). Thue the tax in question purports to be upon the person. There is much authority for the proposition that an income tax is a tax upon the recip- [fol. 80] ient of the income rather than upon the income as a thing. This seems to be the trend of the later decisions. An income tax cannot fairly be called a tax on property within the usual accepted sense of the term. Corpus Juris states that the weight of authority is that the income tax falls more nearly within the category of excise taxes. 61 C. J. 1560. A general income tax on income from all sources is generally recognized as an excise although it may include income from property. 26 Ruling Case Law, page 142. Among the many recent cases discussing at length the character of an income tax where the conclusion is reached that

it is an excise, in addition to the cases last above cited, are Miles v. Department of Treasury, 193 N. E. (Ind.), 855, 97 A. L. R. 1474; and Featherstone v. Norman, 153 S. E. (Georgia), 58, 70 A. L. R. 449. The United States Supreme Court expressly says that an income tax is an excise in Brushaber v. Union Pacific, 240 U. S., 1.

"That a general net income tax is an indirect, rather than a direct tax, is recognized in the oft repeated language of Justice Pitney speaking for the Supreme Court in U. S. Glue Company v. The Town of Oak Creek, 247 U. S. 321 at 328: 'The difference in effect between a tax measured by gross receipts and one measured by net income, recognized by our decisions, is manifest and substantial, and it affords a convenient and workable basis of distinction between a direct and immediate burden upon the business affected and a charge that is only indirect and incidental.'

"Plaintiffs cite as authority for their contention that the statutory exemption is broad enough to exempt the income from the bonds: MacAllen v. Massachusetts, 73 L. Ed. (U. S.), 874; Eisner v. Macomber, 252 U. S. 189; Gillespie [fol. 81] v. Oklahoma, 66 L. Ed. (U. S.) 338; and some other like cases. Only the MacAllen case is in point on its facts. Undoubtedly the MacAllen case is the strongest authority for the plaintiffs. Three Justices dissent. The majority opinion reverses a unanimous decision of the Supreme Court of Massachusetts, which state decision is in line with the argument of defendant in the case now before the court. There appear to be some distinctions between the MacAllen case and the present case. In the first place, the Massachusetts statute creating the exemption that is involved in the MacAllen case is headed '*Persons and* property exempt from taxation' and the statute reads: 'Sec. 5. The following property *and polls* shall be exempt from taxation.' Thus the statute under which the bonds in the MacAllen case were claimed to be exempt undertook to exempt both persons and property. Furthermore, the Massachusetts statute does not purport to be a general income tax statute but applies solely to domestic business corporations. Then, too, under the Massachusetts act, as originally passed, income from tax exempt securities was exempted from the income tax. Subsequently, this exemption of such income was removed, resulting (so the Court felt) in discrimina-

tion against tax-exempt securities. (See Pacific Co. v. Johnson, 285 U. S. 480 at 494.)

"It seems that the MacAllen case is in effect overruled—certainly the weight of its authority is very much lessened, to say the least—by the more recent cases of Pacific Co. v. Johnson, 285 U. S. 480, and Educational Films Corp. v. Ward, 282 U. S. 379. In the Pacific Company case the arguments and briefs of counsel set out with the report of the decision are strikingly similar to the arguments and briefs presented by the attorneys in the case at bar. The Pacific [fol. 82] Company case holds squarely that a tax may be levied against a corporation based upon the entire net income of the corporation including that from tax exempt municipal bonds. The majority of the Court (there were three dissenting Judges) cites the identical cases cited by the Massachusetts Court in its opinion in the MacAllen case (163 N. E. 75) and refuses to follow the majority opinion in the MacAllen case. The majority opinion in the Pacific Company case seems to be a complete answer to plaintiffs' contentions in the present case. The other case, later in point of time than the MacAllen case, Educational Films Corporation v. Ward, 282 U. S. 379, upholds a corporation franchise tax based on net income including income as royalties from copyrights granted by the United States (copyrights were exempt from taxation). Both the majority and dissenting opinions deal very largely with a discussion of the MacAllen case. For a criticism on the MacAllen case in which it is stated that it marks a new attitude toward excise taxes and that it makes the validity of the tax depend upon what the Court concludes the legislative intent to have been, see Note Vol. 30, Columbia Law Review, page 92 at 100. This view expressed in the MacAllen case seems to be repudiated in the Pacific Company case.

"The next case in importance cited by plaintiffs is Gillespie v. Oklahoma, 257 U. S. 501. In Burnet v. Coronado Oil & Gas Company, 285 U. S. 393, at page 398, the Supreme Court says: 'We are disposed to apply the doctrine of Gillespie v. Oklahoma (257 U. S. 501) strictly and only in circumstances closely analogous to those which it disclosed.'

"It is well settled that tax exempt federal, or other bonds are not exempt from state or federal inheritance tax. Plummer v. Coler, 44 L. Ed. 998; Blodgett v. Silberman, 277 [fol. 83] U. S. 1; Greiner v. Lewellyn, 66 L. Ed. 676. In

Peck v. Lowe, 62 L. Ed. 1049, it is held that income from shipping goods to foreign countries and there selling them may be taxed, notwithstanding the constitutional provision that 'No tax or duty shall be laid on articles exported from any state.' In Flint v. Stone Tracy Company, 220 U. S. 107, recognized as authority in the MacAllen case and expressly reaffirmed in the later Pacific Company and Educational Films Corporation cases, it is held that an excise tax on corporations may include income from tax exempt securities. Earlier cases upholding state franchise taxes measured by net property or income including tax exempt bonds or their income are: Society v. Coite, 18 L. Ed. 897; Provident Institute v. Massachusetts, 18 L. Ed. 913; and Home Ins. Co. v. New York, 33 L. Ed. 1025. In U. S. Glue Co. v. Town of Oak Creek, 247 U. S. 321, it is held that a state income tax is valid even though it includes net income derived from transactions in interstate commerce where there is no discrimination against such income.

"For the foregoing reasons it is accordingly by the Court Ordered, Adjudged and Decreed that the assessment herein appealed from is hereby affirmed and upheld and the plaintiffs' appeal therefrom is hereby dismissed and the additional assessment against the plaintiffs, Henry O. Hale and Elizabeth C. Hale, in the sum of $1387.24, hereby stands affirmed. Costs of this case are to be taxed by the Clerk to said plaintiffs."

There is little that could be added to the foregoing carefully prepared opinion of the able trial court. We have carefully examined the authorities cited and read the able arguments of counsel for appellants. We understand their [fol. 84] position but are unable to subscribe to the proposition that a general income tax law imposed upon the entire income is a property tax. This court held in the case of City of Dubuque v. Northwestern Life Ins. Co., 29 Iowa, page 9, decided in 1870, that gross income was not property within the meaning of the law authorizing the city to collect taxes upon "taxable property." The court said: "It certainly cannot be claimed that the gross income of individuals or corporations from any business in which they may be engaged for a specified period without regard to the money or property realized and on hand at the expiration of the time can be properly described by the term property.

No one will pretend that the sum shown as the footing of the debit side of the merchant's cash book, during a year's business, can be called property. The money represented by each item of the account when in his possession was property, but the aggregate of the whole amount of money passing through his hands for a year could not, at the end of that time, when he possessed a small portion of it, be called his property." Neither can we subscribe to the appellants' contention that the law exempting the bonds themselves from taxation likewise exempts the interest, or that the inclusion of the income or interest from the bonds in the total of the gross income of the individual under the income tax law is a tax upon the bonds themselves. It is only fair to assume that the legislature at the time of the enactment or re-enactment of the tax exemption statutes relied upon by appellants was advised of the prior holdings of this court to the effect that the tax exemption laws in this state had been construed by this court as having reference to general property taxes only, and would have therefore specifically broadened the tax exemption provisions subsequently enacted to include taxes other than general property tax, if such was the intention of the legislature. Not having done so, we are not, under the rule of [fol. 85] strict construction applied to tax exemption laws, permitted to enlarge the meaning which the legislature undoubtedly must have intended, and to extend the tax exemption statute to include the interest as well as the bonds themselves. Since the total of a person's entire income over the taxing period is not considered property, as that term is used in the statutes relating to the imposition of taxes upon property, real and personal, and since the tax exemption statutes have reference to a general property tax, which is the construction this court has always placed upon such statutes and of which we must assume the legislature took cognizance, it necessarily follows that the contractual immunity from taxation applicable to the bonds themselves was not intended by the legislature to be extended to include the interest on the bonds or to include a tax other than a general property tax. Neither can we agree with counsel that the tax was imposed "solely because of the ownership of said bonds." There is much more than mere ownership involved in looking after an investment of three quarters of a million dollars, collecting

and reinvesting some $36,000 interest thereon annually. In addition to this they had other securities as well as their farming interests. It required labor, thought, energy, all of which is included with title and ownership in husbanding the large fortune, measured by the holding of the average family, which appellants had accumulated under the beneficent laws and protecting care of their government.

The decree of the trial court is therefore affirmed.

Affirmed.

Richards, C. J., Anderson, Parsons, Stiger, Donegan, JJ., concur.

Mitchell takes no part.

[fols. 86-89] IN SUPREME COURT OF IOWA

43610

HENRY O. HALE and ELIZABETH C. HALE, Appellants,

vs.

IOWA STATE BOARD OF ASSESSMENT AND REVIEW, Appellee

Appeal from Webster District Court

JUDGMENT—January 19, 1937

In this cause, the Court being fully advised in the premises, file their written opinion affirming the judgment of the District Court.

It is therefore considered by the Court that the judgment of the Court below be, and it is hereby, affirmed, and that a writ of procedendo issue accordingly.

It is further considered by the Court that the appellants pay the costs of this appeal, taxed at $61.95 and that execution issue therefor.

[fol. 90] IN SUPREME COURT OF IOWA

EXCERPTS FROM APPELLEE'S BRIEF AND ARGUMENT—Filed August, 1936

"A general constitutional or statutory provision exempting property of a state, county or municipal corporation,

including bonds, from taxation, applies only to general property taxes, and has no application to an excise tax."

"Section 6944 (5) and (22) and Section 4753-A13 of the Code of 1935, exempting certain bonds from taxation, apply only to general property taxes."

"A general income tax law such as we find in Chapter 82 of the Acts of the 45th General Assembly, Extra Session, (Chapter 329-F1 of the Code of 1935), does not provide for a general tax on property, but for an excise tax."

[fol. 91] IN SUPREME COURT OF THE UNITED STATES

[Title omitted]

PRÆCIPE OF APPELLEE FOR TRANSCRIPT OF ADDITIONAL PORTIONS OF RECORD—Filed March 8, 1937

To Honorable B. W. Garrett, Clerk of the Supreme Court of Iowa:

Please include in the transcript of the record to be transmitted to the Supreme Court of the United States, in addition to the portions referred to in appellants' Præcipe, the following:

1. Statement of Appellee against the Jurisdiction of the Supreme Court of the United States, which statement is now on file in the office of the Clerk of the Supreme Court of Iowa.

2. Show the filing date on said Statement against the Jurisdiction of the United States Supreme Court.

3. Acknowledgment of counsel for appellants of service of said Statement against Jurisdiction.

4. From page ten, Appellee's Brief and Argument, the following:

"A general constitutional or statutory provision exempting property of a state, county or municipal corporation, including bonds, from taxation, applies only to general property taxes, and has no application to an excise tax."

5. From page seventeen, Appellee's Brief and Argument [fol. 92] the following statement:

"Section 6944 (5) and (22) and Section 4753-A13 of the Code of 1935, exempting certain bonds from taxation, apply only to general property taxes."

6. From page twenty-five, Appellee's Brief and Argument, the following statement:

"A general income tax law such as we find in Chapter 82 of the Acts of the 45th General Assembly, Extra Session (Chapter 329-F1 of the Code of 1935), does not provide for a general tax on property, but for an excise tax."

7. This Præcipe for Transcript of Additional Portions of the Record, together with the acknowledgment of service.

John H. Mitchell, Attorney General of the State of Iowa. Clair E. Hamilton, Special Assistant Attorney General, Attorneys for Appellee.

[fol. 93] Due, timely and proper service of the foregoing Præcipe of Appellee for Transcript of Additional Portions of Record, and receipt of copy thereof, is acknowledged at Des Moines, Iowa, this 8th day of March A. D. 1937.

Henry O. Hale and Elizabeth C. Hale, Appellants, by Wm. L. Hassett, Alan Loth, Their Attorneys.

[fol. 94] IN SUPREME COURT OF THE UNITED STATES

APPELLANTS' STATEMENT OF POINTS AND DIRECTIONS FOR PRINTING RECORD—Filed March 20, 1937

(A) Points Relied on by Appellants

1. The statutes providing that the bonds "shall not be taxed" inhered in the contracts as a term thereof within the Contract clause of the Federal Constitution.

2. The scope and obligation of the contract claimed to have been impaired, and whether the state statute does impair it, are determined by the United States Supreme Court independently of the State Court's decision appealed from.

3. An income tax on interest, derived solely from the ownership of bonds which are contractually exempt from taxation, violates the immunity and unconstitutionally impairs the contract. It is, essentially, a tax on the bonds. Interest on bonds which are immune from property taxation is therefore immune from income taxation.

4. If the tax were an excise on the privilege of receiving this interest, it would still impair the contractual exemption. An excise on the transmissal or receipt of a fund under a pre-existing vested contractual right impairs the contract. Receiving such payment is not a taxable privilege.

5. Whether the tax infringes the contractual immunity from taxation must be determined by its practical incidence [fol. 95] and effect. It does not even pretend to be an excise or privilege tax.

6. It is stipulated that appellants received this interest "solely by virtue of their ownership of these bonds." In so doing they exercised their absolute right, not a taxable privilege which can be the subject of an excise. The tax cannot be ascribed to any taxable subject other than the property in the bonds, and its incidence must be on the bonds. Terming the income tax on this income an excise is not sufficient to evade the fact that it impairs the contractual immunity of the bonds from taxation.

7. The lower courts were wrong in treating MacAllen v. Massachusetts, 278 U. S. 620, and Gillespie v. Oklahoma, 257 U. S. 501, as overruled by Educational Films Co. v. Ward, 282 U. S. 379, and similar cases. The latter hold that a tax on the privilege of exercising a corporate franchise may be measured by income; and reaffirm the rule that if the tax is in fact an income tax and not a franchise tax, it cannot be laid on income from exempt property (which is what we here claim).

8. Such cases as Norman v. Featherstone, cited in the opinions below, have no application here, merely holding that a graduated income tax is generally not forbidden by constitutional requirement of uniformity in taxation.

9. The statutes giving the immunity embrace all forms of property taxation, and cannot be construed to refer only to forms of taxation in vogue when they were passed, and thus to permit the income tax as a new form of property taxation.

10. The Iowa court had never held that the exemption statutes applied only to "general" property taxes (whatever that may mean). It had only held that the exemption does not apply to franchise or privilege taxes, or to special assessments for special benefits.

[fol. 96] 11. The original exemption statutes, which alone constitute our contract, cannot be narrowed by construing them as limited by the Income Tax Law, passed years later, which impairs that contract.

12. The assumption of the State Supreme Court that appellants can be treated as exercising some taxable privilege is without support, and is directly contradicted by the stipulation that they received the income solely by virtue of the mere ownership of their property. Indeed, nothing assumed by the Iowa court constitutes a taxable privilege.

13. Dubuque v. Northwestern Life Ins. Co., 29 Iowa 9, is inapplicable because it dealt with a wholly different situation and was controlled by the very different wording of the old statute, no longer in force.

14. The Iowa Income Tax law construed to impair the contract and infringe the individual rights of these appellants is invalid as to them, regardless of its general validity as to others.

(B) Designation of Record to Be Printed

Appellants state that it is necessary to print the entire record as certified to this Court from the Supreme Court of the State of Iowa, save only the following which may be omitted in printing:

1. The bond for appeal which appears at Pages 8 and 9 of the Record as certified.

2. The oral testimony of William L. Hassett commencing at line 14, page 54, and ending with line 3, page 58 of the record as certified by the Supreme Court of Iowa (further identified as commencing at line 14, page 14 and ending with line 3, page 18 of the abstract of record which was filed in the Supreme Court of Iowa).

[fol. 97] 3. Exhibits B and C, commencing at line 6, page 58 and ending with line 11, page 59 of the record as certified by the Supreme Court of Iowa (further identified as commencing at line 6, page 18 and ending with line 11, page 19 of the abstract of record filed in the Supreme Court of Iowa).

4. Omit the opinion of the trial court beginning at line 17, page 59 and ending with line 20, at page 68 of the record as certified by the Supreme Court of Iowa (further identified as commencing at line 17, page 19 and ending with line 20, page 28 of the abstract of record in the Supreme Court of Iowa). However, there should be inserted in lieu of this trial court opinion a statement that the same is incorporated verbatim in the opinion of the Iowa Supreme Court.

And accordingly, appellants designate for printing the entire record herein, except the foregoing.

Denis M. Kelleher, Attorney for Appellants.

Service of the foregoing and receipt of copy is admitted and acknowledged this 12th day of March, 1937.

John H. Mitchell, Clair E. Hamilton, Attorney- for Appellee.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1936

No. [redacted] 16

HENRY O. HALE AND ELIZABETH C. HALE,
Appellants,

vs.

THE IOWA STATE BOARD OF ASSESSMENT AND REVIEW.

APPEAL FROM THE SUPREME COURT OF THE STATE OF IOWA.

STATEMENT AS TO JURISDICTION.

DAVID M. [redacted]
[redacted]
WM. [redacted]

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1936

No. 832

HENRY O. HALE AND ELIZABETH C. HALE,
Appellants,

vs.

THE IOWA STATE BOARD OF ASSESSMENT AND REVIEW,
Appellee.

STATEMENT AS TO JURISDICTION OF THE SUPREME COURT OF THE UNITED STATES.

To show the jurisdiction of the Supreme Court of the United States, appellants state:

(A) Statute Sustaining Jurisdiction.

The statutes sutaining jurisdiction are:

United States Code, title 28, sections 344(a); 861 (a), (b).

(These permit appeals from final judgment of the highest State court, when adverse to the claim that a State statute violates the Federal Constitution.)

(B) State Statute Challenged.

We attack the validity of the Iowa "Personal Net Income Tax Law" passed March 8, 1934, found in:

1935 Code of Iowa; sections 6943-f-4 to 6943-f-27 (pp. 999-1006).

Its declared purpose is "the direct replacement of taxes * * * on property" to the extent of the net revenues obtained under it (Sec. 6943-f-2). It imposes an annual tax "upon every resident of the State * * * upon and with respect to his entire taxable income" (Sec. 6943-f-5). Such income is defined as gross income, less: interest from obligations of the United States and its instrumentalities, Federal salaries and pensions, and other items not here material (Sec. 6943-f-8, d, e). It does not purport to impose a franchise or privilege tax. It is applicable only to persons; not to corporations (6943-f-4, 2). There is a separate franchise tax on corporations, measured by their net income; but that is not here involved (Code, Sec. 6943-f-28, et seq.).

The statute is construed to include in the individual's taxable income, interest on tax-exempt bonds of Iowa and its municipalities, which bonds had been theretofore issued under previous statutes (having the force of contracts) providing that such bonds "shall not be taxed" (Iowa Code, sections 6944-(5); 4753-a-13; Acts 39 G. A. Ch. 332, Sec. 10). It is challenged in this respect, as impairing the obligation of the contracts in violation of Article I, section 10, of the Federal Constitution.

(C) Dates of Judgment and Appeal.

The final judgment and decision of the Iowa Supreme Court (the highest court of that State) was entered January 19, 1937. Petition for appeal was filed and allowed February 23, 1937.

(D) **Nature of the Case, etc.**

To show the jurisdiction of the Supreme Court of the United States, the case, the State and manner of presenting the question and the rulings, can best be stated together. (References to the record are to the printed abstract in the Iowa Supreme Court.)

Nature of the Case.

Iowa Code, Sec. 6943-f-24, 25, provides that assessments of income taxes are contested: first, by application to the State Board of Assessment and Review for their abatement; then by equitable action in the trial court appealing from the Board's refusal to abate (where the case is tried anew); then by appeal to the Iowa Supreme Court from the lower court's decision. This is a case under that statute, and is stipulated to be in compliance with it. (Printed Abstract in Iowa Supreme Court, p. 8, line 30, to p. 9, line 20.)

Appellants made return of their 1935 income, which disclosed interest from Iowa tax-exempt bonds, but did not include it as taxable income, claiming the Income Tax Law is unconstitutional if it requires such inclusion (Abst., p. 7, lines 1-33). The Board, ex parte, assessed a tax of $1,384.24 solely on account of this interest, reserving the right to apply for its abatement (Abst., p. 8, lines 1-26).

Question Raised Before the Board.

Appellants applied to the Board for abatement on the ground that their contracts were unconstitutionally impaired by the statute making this interest taxable. This claim was written exactly as in their petition before the trial court, next set out herein (Abst., p. 8, line 30, ff).

Ruling of the Board.

The Board overruled the application without opinion (Abst., p. 9, line 33).

Question Raised Before Trial Court.

Appellants filed their petition in the trial court, which after setting out the foregoing proceedings, alleged:

That in 1909 and thereafter, Iowa enacted statutes (now in 1935 Code as Sections 6944-(5); 4753-a-13; and Acts 39 G. A. Ch. 332, Sec. 10) that bonds of Iowa and its subdivisions, such as are here involved, "shall not be taxed"; that the bonds were issued in Iowa under these statutes, direct to appellants or those from whom they bought them; that all the interest here involved was paid strictly according to the terms of the bonds, and was received by appellants "solely because of their ownership" of said bonds (Abst., pp. 2, 3, 4). The petition then alleged:

> "That upon the issuance of * * * said bonds, a contract arose * * *; that the aforesaid statutory immunity from taxation became part of such contract; that the holder of each bond * * * held a contract that such bond should not be taxed. * * * That accordingly, the assessment * * * impairs the obligation of plaintiffs' contracts * * * in violation of the rights * * * which are guaranteed to them by Article I, Section 10, of the Constitution of the United States. * * *
>
> "That (the Iowa Income Tax Law), if construed to authorize such assessment, is in that respect unconstitutional and void, and violates the contractual rights of plaintiffs above referred to * * *
>
> "That the assessment * * * is in essence, operation and effect * * * an attempt to tax the bonds contrary to * * * plaintiffs' contractual and constitutional rights above mentioned. That the assessment is upon interest received wholly and directly on

> said bonds * * * that plaintiffs had no other income on which any tax was or could be claimed; that plaintiffs * * * had the absolute and inviolable right to receive such interest, which right was not, and could not be made the subject of any excise or privilege tax; nor does (the Income Tax Law) impose an excise or privilege tax on the receipt of income such as is here involved, nor could it constitutionally do so without impairing the obligation of plaintiffs' contract * * *'' (Abst., p. 5, line 7 to page 6, line 11).

The defense was that the Iowa Personal Income Tax law laid no tax on the bonds, but only an excise (Abst., p. 11, lines 1 to 21).

It was stipulated that appellants owned and had acquired the bonds as claimed, and under the tax-exemption statutes relied on; that the interest "was received solely by virtue of such ownership"; that all the bonds antedated the passage of the Income Tax Law, with a trifling exception (Abst., p. 7, line 10; p. 12, line 31, to p. 13, line 19).

Ruling in the Trial Court.

The trial court held the Income Tax Law embraced this interest; stated that the question was whether the tax on income from these bonds resulted in the impairment of a contractual obligation in violation of the Federal Constitution; assumed that the exemption was contractual; and held that, while the question was not free from doubt, the contract was not impaired because the income tax was not a tax on the bonds, but "in the nature of an excise". Judgment was entered accordingly, confirming the assessment (Abst., p. 20, line 17, ff). Due exception was taken thereto (Abst., p. 28, line 19).

The trial court's opinion is incorporated *verbatim* in the Supreme Court opinion appended hereto, and so is not separately copied.

Question Raised Before Iowa Supreme Court.

Appeal was taken to the Iowa Supreme Court. Assignments of error have been abolished in Iowa (Code, Sec. 12869), and the points are made in the appellate brief. Pursuant to the State practice, appellants raised the question in the State Supreme Court in their brief by the following "specifications" which were fully elaborated with citations and arguments:

> "The court erred in adjudging that * * * the income tax law does not 'result in the impairment of any constitutional obligation in violation of the federal constitution' * * * Such tax impairs the obligation of the contract, in violation of Section 10 of Article I of the Federal Constitution, because:
>
> "1. The statutory exemption created a contract with the bondholders which cannot be impaired by a later tax;
>
> "2. A tax on individual income derived solely from the ownership of tax-exempt securities violates the exemption;
>
> "3. The tax on this income cannot be a privilege tax so as to escape the exemption, because plaintiffs exercise no privilege to which the tax can be ascribed. It is therefore a tax imposed solely because of their ownership of the bonds; and that is a property tax within the exemption;
>
> "4. The authorities relied on by the trial court do not support his decision * * *" (Appellants' Brief in Iowa Supreme Court, pp. 5, 6).

Decision of Iowa Supreme Court.

The Iowa Supreme Court treated the federal question as raised, and decided it. That court adopted the trial court's opinion verbatim, after stating in substance that the whole question is whether the obligation of appellants' contracts

is unconstitutionally impaired by the Iowa Income Tax Law (construed to impose the tax). It affirmed the lower court, and entered final judgment accordingly. Copy of its opinion is attached hereto.

(E) The Federal Question is Substantial.

The question is whether a contract that the bonds "shall not be taxed" is impaired by a later statute imposing an income tax on their interest. Both lower courts stated that the question was not free from doubt.

1. The existence of a contract is unquestionable. It was assumed below that the statutes directing these bonds "shall not be taxed" inhered in the contract. Such exemption is contractual, within the contract clause of the Federal Constitution:

MacAllen v. *Massachusetts,* 279 U. S. 620, at 634;
Murray v. *Charleston,* 96 U. S. 432;
Merchants Insurance Co. v. *Newark,* 54 N. J. L. 70, 23 Atl. 305;
Re Assessment of First National Bank, 58 Okla. 508, 160 Pac. 469;
The Pacific Railway v. *Maguire,* 20 Wall. 36;
Choate v. *Trapp,* 224 U. S. 665;
Farrington v. *Tennessee,* 95 U. S. 679;
Humphrey v. *Pugues,* 16 Wall. 326;
Cooley 'Taxation', pp. 355, 356;
26 *Ruling Case Law* 92.

In deciding whether there has been an unconstitutional impairment of the contract, the Supreme Court of the United States must determine independently both the scope of the contract, and whether the later statute does impair it.

On these points the State court's decision is not conclusive, and is often reversed:

United States Mortgage Co. v. *Mathews*, 293 U. S. 232, at 236;

Columbia Ry. Co. v. *South Carolina*, 261 U. S. 236, at 245;

Detroit United Ry. v. *Michigan*, 242 U. S. 238, at 249;

Louisiana &c. Ry. v. *Behrman*, 235 U. S. 164, at 170, 171.

3. Where securities are contractually immune from taxation, an income tax law which includes interest derived solely from their ownership, violates the immunity and unconstitutionally impairs the contract. An income tax on such interest is essentially a tax on the bonds. Whenever the bonds are exempt from property taxation, the income therefrom is likewise exempt from income taxation:

MacAllen Co. v. *Massachusetts*, 279 U. S. 620, at 622, 634;

Northwestern Mutual Life Ins. Co. v. *Wisconsin*, 275 U. S. 136, at 140;

National Life Insurance Co. v. *United States*, 277 U. S. 508, at 519, 20, 21;

Gillespie v. *Oklahoma*, 257 U. S., 501, at 505;

Pollock v. *Farmers Loan & Trust Co.*, 157 U. S. 429, at 558, 581;

Pollock v. *Farmers Loan & Trust Co.*, 158 U. S. 601, at 617, 637;

Knowlton v. *Moore*, 178 U. S. 41, at 46, 52, 53;

Eisner v. *Macomber*, 252 U. S. 189, at 205;

The Pacific Railway Co. v. *Maguire*, 20 Wall. 36;

Hobart Estates Co. v. *State Board*, 1 Cal. App. (2) 328, 36 Pac. (2) 407 at 409;

Kelly v. *Kalodner*, 320 Pa. 180, 181 Atl. 598, at 600, 601;

Re Opinion of Justices, 220 Mass. 613, 108 N. E. 570, at 574;

Hart v. *Tax Commission*, 240 Mass. 37, 132 N. E. 621, at 622.

4. Even if the income tax were an excise on the privilege of receiving this interest, it would impair the obligation of the contractual exemption. When one has a fixed, vested contractual right to receive money or property, a later excise tax on the transmissal or receipt thereof impairs the obligation of that contract.

Coolidge v. *Long*, 282 U. S. 582, at 595.

Receiving payment under a pre-existing contract cannot be made the subject of an excise or privilege tax, because such receipt is an absolute right, and not a taxable privilege.

Tax Commission v. *Rife*, 119 Ohio St. 83, 162 N. E. 390;

Re Morrison's Estate, 224 N. Y. Suppl. 346.

5. Whether the tax infringes the contractual immunity from taxation must be determined by its practical incidence and effect, and not by any form of words:

Home Insurance Co. v. *New York*, 134 U. S. 594;

Galveston Ry. v. *Texas*, 210 U. S. 217;

Dawson v. *Kentucky Distillers Co.*, 255 U. S. 288, at 292.

6. The incidence of this tax must be on the bonds or their ownership (which is the same thing) because appellants exercise no privilege and do no act which can be made the subject of any excise. It is stipulated that they simply receive this interest, solely by virtue of their ownership of these bonds. That is not a privilege which can be made the subject of an excise, but an absolute right. The tax here cannot be ascribed to any taxable subject other than the property in the bonds; and so an income tax on this income cannot be termed an excise to evade the exemption:

Dawson v. *Kentucky Distillers Co.*, 255 U. S. 288, at 293, 294;

Jensen v. *Henneford* (Wash.), 53 Pac. (2) 607, at 610;

Corn v. *Fort* (Tenn.), 95 S. W. (2) 620, at 623;
Redfield v. *Fletcher,* 135 Ore. 180, 292 Pac. 813, at 819;
Opinion of Justices, 195 Mass. 607, 84 N. E. 499, at 503;
Ingels v. *Riley* (Cal.), 53 Pac. (2) 939, at 942;
Willcutts v. *Bunn,* 282 U. S. 216, at 227, 228;
Coolidge v. *Long,* 282 U. S. 582, at 595;
Helson v. *Kentucky,* 279 U. S. 245;
Thompson v. *McLeod,* 112 Miss. 383, 73 So. 193, at 194;
Tax Commission v. *Rife,* 119 Ohio St. 83, 162 N. E. 390;
Morrison's Estate, 224 N. Y. Suppl. 346;
Also cases cited under Paragraph 2, *supra.*

7. There is no foundation for the view of the courts below that *MacAllen* v. *Massachusetts* and *Gillespie* v. *Oklahoma* have been overruled by the United States Supreme Court, or that the rule that an income tax cannot be laid on income from tax-exempt property has been repudiated. The cases cited as overruling said decisions merely uphold as an excise a tax on the privilege of exercising a corporate franchise (though measured by income), and distinctly uphold the rule that if the tax is in fact an income tax, and not a franchise tax, it may not be imposed on such income as ours:

Pacific Co. v. *Johnson,* 285 U. S. 480, at 89, 90, 96;
Educational Films Co. v. *Ward,* 282 U. S. 379, at 88, 89, 91.

8. It cannot be said that the tax-exemption contracts applied only to such "general-property taxes" as were in force when they were passed. In terms they apply to all forms of taxation which burden the bonds exempted, and cannot be read to except income taxes from their application:

Farrington v. *Tennessee,* 95 U. S. 679;
Pacific Railway Co. v. *Maguire,* 20 Wall 36;
Evans v. *Gore,* 253 U. S. 245 at 256;
Federal Land Bank v. *Crossland,* 261 U. S. 374.

9. The Iowa court had never held that the tax-exemption statute we invoke applied only to "general" property taxes. The only Iowa cases remotely applicable affected other exemptions and other kinds of taxes. These are:

(a) Statutes exempting municipally-owned property from taxes do not apply to special assessments for local improvements, because these are not taxes but payments for special benefits:

Sioux City v. *School District*, 55 Iowa 150, 7 N. W. 488;
Edwards v. *Jasper County*, 117 Iowa 365, 90 N. W. 1006.

(b) Statutes exempting municipally-owned property from taxes do not apply to an excise tax levied on gasoline used on the State highways to compensate for the privilege of using those highways:

State v. *Des Moines*, 266 N. W. 41.

(c) Statute exempting property from taxation does not prohibit a license tax for the privilege of exercising a corporate franchise:

Iowa Mutual Ins. Co. v. *Gilbertson*, 129 Iowa 658, 106 N. W. 153.

These cases obviously have no bearing on our claim that our exemption statute does forbid the tax here laid on us.

10. Our rights are measured by the contract as it was prior to March, 1934, when the Income Tax Law was passed. The suggestion that the exemption statutes of 1909 be construed *in pari materia* with the income tax law of 1934 cannot be accepted. Construction of the former statutes cannot be aided by a separate law enacted many years afterward:

Penn Mutual Life Ins. Co. v. *Lederer*, 252 U. S. 523;
People v. *Central Illinois Pub. Serv. Co.*, 328 Ill. 440, 159 N. E. 797;
Appelby v. *New York*, 261 U. S. 364 at 380.

11. A valid tax law construed and applied to impair a contract and thus to infringe the rights of an individual taxpayer is invalid as to him, regardless of its general validity:

General Oil Co. v. *Clark,* 209 U. S. 211, at 228;
White v. *Johnson,* 282 U. S. 367, at 373.

(F) Opinions Below.

Appended hereto is the opinion of the Supreme Court of Iowa. It incorporates *verbatim* the trial court's opinion, which is not therefore separately reproduced.

Respectfully submitted,

DENIS M. KELLEHER,
ALAN LOTH,
WM. L. HASSETT,
Attorneys for Appellants.

EXHIBIT "A".

IN THE SUPREME COURT OF IOWA.

Filed January 19, 1937.

43610.

HENRY O. HALE and ELIZABETH C. HALE, *Appellants*,

vs.

IOWA STATE BOARD OF ASSESSMENT AND REVIEW, *Appellee*.

Appeal from Webster County District Court.

Hon. T. G. GARFIELD, Judge.

Suit in equity to annul an Iowa income tax assessment against the plaintiffs, the income consisting solely of interest received on tax exempt municipal securities. It is the claim of plaintiffs that the assessment is in reality upon the bonds themselves and therefore impairs the contractual immunity from taxation which inheres in the bonds and is violative of Article I, Section 10 of the Federal Constitution, and further that the Iowa Income Tax Act does not authorize assessing such interest as taxable income. By way of defense it is alleged and claimed by the appellee that the Iowa Income Tax Act is a general income tax law and includes all income not specifically exempted by the act itself, and that interest on tax exempt municipal securities such as those owned by the plaintiff are not exempted by the provisions of the income tax act and therefore such interest, along with all other taxable income is subject to the tax, and that this is not a property tax but an excise tax and not a tax on the bonds themselves, and that the general tax exemption statutes have reference to direct property tax and not to an excise tax, and that therefore the income tax act does authorize the imposition of said tax upon the interest received by the plaintiffs from the municipal securities owned by them, and that the tax is a valid exercise of the taxing power of the state and does not violate any constitutional provision, and the imposition of said tax does not

impair any contractual immunity under the constitution. The trial court denied the plaintiff's petition and upheld the tax and plaintiffs have appealed.

Affirmed.

ALAN LOTH, of Fort Dodge, and
WILLIAM L. HASSETT, of Des Moines,
Attorneys for Appellants.
CLAIR E. HAMILTON, Special Assistant
Attorney General, of Winterset,
Attorney for Appellee.

HAMILTON, *J.*:

The facts are not in dispute and briefly stated are as follows:

During the month of January, 1936, plaintiffs, who were husband and wife, filed with the Iowa State Board of Assessment and Review a joint income tax return, in which they reported that they were engaged in no business but were farm owners and investors. They reported interest from all sources, including exempt interest in the sum of $1,322.69. In the report they state that in addition to the interest reported they held bonds during 1935 and received interest therefrom as follows:

	Principal.	Interest.
State of Iowa, Soldiers Bonus bonds	$1,000.00	$45.00
Iowa School District bonds	666,900.00	32,648.75
Road Bonds of Iowa Counties	82,000.00	4,072.50
County Bonds	3,000.00	127.50
Totals	$752,900.00	$36,893.75

Under the heading of "Income from rents and royalties" they report a deficit of $5,031.16. From this they deduct the $1,322.69 leaving a deficit or loss in taxable income of $3,708.47. They also report deductions for interest, taxes, contributions to charities, etc. of $3,120.50 or a net income deficit of $6,828.97. They decline to pay the tax on the $36,893.75 interest received from the municipal securities above listed, claiming that this interest was received on

tax exempt bonds, and that the Iowa Income Tax Act does not impose a tax on said items of interest, and that if it did it would as to the bonds issued prior to its passage be unconstitutional, and they accordingly refuse to pay any tax upon said items of interest. The Iowa State Board of Assessment and Review corrected said return by charging the plaintiffs with an additional income tax because of the interest received on said bonds, making the amount of the net income $30,064.78, (after allowing the deficit of $6,828.97 as disclosed by the plaintiff's tax report) tax upon which would be $1,403.24, less personal exemption and credit for dependents of $16.00, leaving a total tax imposed as corrected of $1,384.24, and under date of February 8, 1936, gave the plaintiffs notice of assessment in accordance with the statute. In due time the plaintiffs made application for abatement of said tax and appealed for revision of the tax to the board, setting up in said application the same specifications as are contained in their petition in this action. There was a hearing before the board, affirming the tax as corrected and overruling the application of the plaintiffs for a revision and abatement of the tax. In due time and in accordance with the statutory provisions plaintiff appealed from said order to the district court, and it is conceded that in all respects the statutory procedure has been complied with, both in imposing the tax and in raising the legal questions presented to this court.

Appellants emphasize very strongly in their argument that the interest received, being so received solely because of the incident of ownership of the bonds, could not be considered a gain or profit derived from any business or profession, and hence would not fall under the general classification of excise tax known and referred to as a tax on the privilege of transacting a business or occupation, and since the income was received solely as an incident to ownership and because of their ownership of said bonds, the appellants go one step farther and insist that this assessment was made solely because of the ownership of said bonds and therefore is a tax upon the bonds themselves.

We do not think it can be truthfully said that these plaintiffs were engaged in no business, in the broadest sense of

that term. They list themselves as farm owners and investors. Their business therefore must be held to be that of looking after their farming interest and investing their capital. The extent of their farm business is only revealed by the deficit in income from rents and royalties listed in their report as $5,031.16. This deficit no doubt is carried over from a separate farm income report, showing this deficit. Their ownership of other securities in addition to the municipal bonds, interest from which they claim is not taxable, is only shown by the amount of interest from all sources in the sum of $1,322.69. The fact that they had most of their wealth invested in tax exempt securities in no way detracts from their status as investors of capital. They might be carrying on an investment business of several million dollars and own nothing but tax exempt securities and still contend that they had no business. Their capital investments in these tax exempt securities amounted to three quarters of a million dollars and they realized a gain or profit by way of interest on their investment of $36,893.75, and while they were not engaged in the business of farming in the sense that they operated the farm or farms owned by them, but in the sense that the farms represented a part of their investments of their capital, labor, service and energy expended in an endeavor to make the farms pay or realize returns on such investment, they might well be said to be also engaged in the business of farming.

The case was ably presented by counsel representing the respective parties. The trial court took time to consider the facts and the law presented and rendered his decision in writing, which shows a careful analysis of the entire matter, and which we are incorporating at length in this opinion, and which reads as follows:

"The case presents the question whether income from tax exempt securities is subject to the state income tax.

Plaintiffs argue that the Income Tax Statutes do not authorize the tax sought to be enforced. It seems clear from a reading of the Income Tax law that it is the expressed intent of the Legislature that this income is taxable. Code Section 6943-f7 provides: 'The term "net income" means the gross income of the taxpayer less the deductions allowed

by this division." The following section defines 'gross income' as 'gains, profits and incomes derived * * * from interest, rent, dividends, securities, or * * * from any source whatever and in whatever form paid.' Par. 2 of the same section (6943-f8) contains an enumeration of the items exempt from the operation of the income tax, among which is: 'd. Interest upon the obligations of the United States or its possessions, agencies, or instrumentalities, which is or shall be exempt from State taxation by federal law.' The statutory definition of income is clearly broad enough to include the income in question. The statute having exempted several items from the effect of the tax (Including interest on obligations of the Federal government) it must be presumed that the legislature would have included interest from municipal bonds among the exemptions, if such hrad been its intent. As authority for this conclusion see, Willcuts v. Bunn, 75 L. Ed. (U. S. 304 at 306, where the Supreme Court places an analogous interpretation on the Federal Act. And, also in point on this question is Appeal of Van Dyke, 259 N. W. (Wis.), 700 at 704.

Does the operation of the tax on the income derived from the bonds involved in this case result in the impairment of any contractual obligation in violation of the State or Federal Constitutions?

The conclusion above reached on the question of construction of the Income Tax Statutes leads to the result that as to the bonds issued after the Income Tax law went into effect (of the face value of $27,000) the interest therefrom is subject to the tax imposed by the defendant.

All of the securities here involved, other than the $27,000 above referred to, were issued before the effective date of the Income Tax law. All the bonds were issued pursuant to statutory authority. The exemption statute applicable to most of the bonds is Code Section 6944, the first section in Chapter 330, which chapter is entitled: 'Property Exempt and Taxable.' The section reads: 'The following classes of property shall not be taxed: * * * 5. Public securities. Bonds or certificates issued by any municipality, school district, drainage or levee district * * *, or

County within the State of Iowa. * * * 22. Soldiers bonus bonds.' Code Section 6953 provides: 'What taxable. All other property, real or personal, is subject to taxation in the manner prescribed.' Part of the bonds in question were exempted also by Code Section 4753-a13, reading as follows: 'Bonds and road certificates * * * shall not be taxed.' The exemption provided by Section 4753-a13 surely is no more broad than the exemption stated in Section 6944.

Plaintiffs contend that the foregoing exemption constitutes of contractual obligation and that it is broad enough to exempt not only the bonds but also the income derived from the bonds from the income tax. It will be assumed that the exemption is in the nature of a contractual obligation which cannot be impaired. Perhaps it could be contended with some force by the defendant that the exemption is not contractual but merely declaratory of a legislative policy which is not irrevocable. On this point, see Wisc. & M. R. Co. v. Powers, 48 L. Ed.; (U. S.) 229. The serious question is whether the statutory exemption of the bonds, conceding it to be contractual, is broad enough to include exemption of the income from the securities from the income tax. Defendant contends that the statutory exemption applies only to general property taxation and that the income tax is not a property tax but is an excise tax. It is undoubtedly the general rule that an exemption from property tax does not constitute an exemption from an excise tax. In order to sustain the tax in question is is not necessary fully to adopt the defendant's contentions. The tax is enforceable if the statutory exemption of the bonds is too narrow to exempt the income from the operation of the income tax. Although the matter is not wholly free from doubt, it seems fairly clear that the exemption is not so broad as plaintiffs contend and that the income tax is enforceable. Following are the principal reasons and some of the authorities to be given in support of this conclusion.

'Taxation is the rule and exemption the exception, and therefore, strict construction of the statute (now Code Section 6944) under which the exemption is claimed, is the rule.' City of Sioux City v. School District, 55 Iowa, 150

at 152. "Grants of immunity from taxation, in derogation of a sovereign power of the State, are strictly construed.' Pacific Co. v. Johnson, 285 U. S. 480 at 491. The authorities make it clear that the statutory exemption must be given a strict and somewhat narrow construction is distinguished from a liberal and broad construction. It is also clear that every presumption is indulged in favor of the constitutionality of the income tax statute; that it must be upheld unless its invalidity is manifest beyond a reasonable doubt. Code Section 6944 must, if fairly possible, be so construed as to save the constitutionality of the income tax law.

The exemption statute itself—construed in the light of the foregoing rules—seems to be applicable only to property taxation. The wording of the section (6944) itself so indicates. And see Code Section 6953. The Iowa Court has so construed this same section in cases where it was sought to exempt public property from special assessments. Sioux City v. School District, 55 Iowa, 150; E. & W. Construction Co. v. Jasper County, 117 Iowa, 365. And in a case where it was sought to have exempted property owned by an alleged charitable institution from a business or license tax the same construction was placed on the same statute. Iowa Mut. Tornado Ins. Ass'n v. Gilbertson, 129 Iowa, 658. In State v. City of Des Moines, No. 43016, decided March 17, 1936, it is held that the same statute (exempting property of a city from taxation) does not exempt a city from paying the state gasoline tax on gasoline owned and used by the city, the court saying that the gasoline tax is not a property tax but an excise tax. This last decision is in line with numerous decisions from many different jurisdictions under strikingly similar statutory provisions. Some of the many authorities are cited in the City of Des Moines case.

There is much respectable authority in other jurisdictions sustaining the view that a similar statutory exemption of municipal bonds from taxation refers only to general property taxes and not to such a tax as the income tax. Appeal of Van Dyke, 259 N. W. (Wisc.), 700, so holds. People v. Gilchrist, 67 L. Ed. (U. S.) 883, recognizes the doctrine for which defendant contends by affirming a decision of the New York Court of Appeals in the following words (quoting from page 893):

'Considering that only the principal of mortgages was taxed when the law was passed, and that in those days no one thought of an income tax; *that any contract of exemption must be shown to have been indisputably within the intention of the legislature;* that it is difficult to believe that the legislature meant to barter away all its powers to meet future exigencies for the mere payment of a mortgage recording tax; and that a tax upon the individual, measured by net income, might be regarded as one step removed from a tax on the capital from which the income was derived (Wm. E. Peck & Co. v. Lowe, 247 U. S. 165) it (N. Y. Ct. of Appeals) held that there was no promise that the present (income) tax should not be imposed.'

The validity of state income tax statutes has most generally been called into question in the courts under constitutional provisions requiring that all property shall be taxed uniformly according to its true value. Apparently most of the states have constitutional provisions of this character. Although there are a few exceptions, it has most generally been held in most jurisdictions that such constitutional provisions apply only to property taxation; that income is not 'property' within the law of taxation; that an income tax is not a property tax but falls more nearly within the category of excise taxes. Some of the many authorities so holding are O'Connell v. Board, 25 Pac. 2nd (Mont.), 114; Diefendorf v. Gallet, 10 Pac. 2nd (Idaho), 307; Maxwell v. Mfg. Co., 168 S. E. (N. C.), 397; Bacon v. Ranson, 56 S. W. 2nd (Missouri), 786; State v. Nichols, 265 N. W. (N. D.), 859.

In Black on Income and Other Federal Taxes (3rd Ed., Sec. 44) it is said:

'The term "property" as used in reference to taxation means the corpus of an estate or investment as distinguished from the annual gain or revenue from it.'

It seems unnecessary to determine the question whether an income tax is, strictly speaking, an excise tax. The Iowa Income Tax Act, in terms, imposes a tax 'upon every resident of the state, which tax shall be levied, collected and

paid annually upon and with respect to his entire taxable income, etc.' (Code 6943-f5). Thus the tax in question purports to be upon the person. There is much authority for the proposition that an income tax is a tax upon the recipient of the income rather than upon the income as a thing. This seems to be the trend of the later decisions. An income tax cannot fairly be called a tax on property within the usual accepted sense of the term. Corpus Juris states that the weight of authority is that the income tax falls more nearly within the category of excise taxes. 61 C. J., 1560. A general income tax on income from all sources is generally recognized as an excise although it may include income from property. 26 Ruling Case Law, page 142. Among the many recent cases discussing at length the character of an income tax where the conclusion is reached that it is an excise, in addition to the cases last above cited, are Miles v. Department of Treasury, 193 N. E. (Ind.), 855, 97 A. L. R. 1474; and Featherstone v. Norman, 153 S. E. (Georgia), 58, 70 A. L. R. 449. The United States Supreme Court expressly says that an income tax is an excise in Brushaber v. Union Pacific, 240 U. S., 1.

That a general net income tax is an indirect, rather than a direct tax, is recognized in the oft repeated language of Justice Pitney speaking for the Supreme Court in U. S. Glue Company v. The Town of Oak Creek, 247 U. S. 321 at 328: 'The difference in effect between a tax measured by gross receipts and one measured by net income, recognized by our decisions, is manifest and substantial, and it affords a convenient and workable basis of distinction between a direct and immediate burden upon the business affected and a charge that is only indirect and incidental.'

Plaintiffs cite as authority for their contention that the statutory exemption is broad enough to exempt the income from the bonds: Mac Allen v. Massachusetts, 73 L. Ed. (U. S.), 874; Eisner v. Macomber, 252 U. S. 189; Gillespie v. Oklahoma, 66 L. Ed. (U. S.) 338; and some other like cases. Only the Mac Allen case is in point on its facts. Undoubtedly the Mac Allen case is the strongest authority for the plaintiffs. Three Justices dissent. The majority opinion reverses a unanimous decision of the Supreme Court

of Massachusetts, which state decision is in line with the argument of defendant in the case now before the court. There appear to be some distinctions between the Mac Allen case and the present case. In the first place, the Massachusetts statute creating the exemption that is involved in the Mac Allen case is headed '*Persons and* property exempt from taxation' and the statute reads: 'Sec. 5. The following property *and polls* shall be exempt from taxation.' Thus the statute under which the bonds in the Mac Allen case were claimed to be exempt undertook to exempt both persons and property. Furthermore, the Massachusetts statute does not purport to be a general income tax statute but applies solely to domestic business corporations. Then, too, under the Massachusetts act, as originally passed, income from tax exempt securities was exempted from the income tax. Subsequently, this exemption of such income was removed, resulting (so the Court felt) in discrimination against tax-exempt securities. (See Pacific Co. v. Johnson, 285 U. S. 480 at 494.)

It seems that the Mac Allen case is in effect overruled—certainly the weight of its authority is very much lessened, to say the least—by the more recent cases of Pacific Co. v. Johnson, 285 U. S. 480, and Educational Films Corp. v. Ward, 282 U. S. 379. In the Pacific Company case the arguments and briefs of counsel set out with the report of the decision are strikingly similar to the arguments and briefs presented by the attorneys in the case at bar. The Pacific Company case holds squarely that a tax may be levied against a corporation based upon the entire net income of the corporation including that from tax exempt municipal bonds. The majority of the Court (there were three dissenting Judges) cites the identical cases cited by the Massachusetts Court in its opinion in the Mac Allen case (163 N. E. 75) and refuses to follow the majority opinion in the Mac Allen case. The majority opinion in the Pacific Company case seems to be a complete answer to plaintiffs' contentions in the present case. The other case, later in point of time than the Mac Allen case, Educational Films Corporation v. Ward, 282 U. S., 379, upholds a corporation franchise tax based on net income including income as royalties from

copyrights granted by the United States (copyrights were exempt from taxation). Both the majority and dissenting opinions deal very largely with a discussion of the Mac Allen case. For a criticism on the Mac Allen case in which it is stated that it marks a new attitude toward excise taxes and that it makes the validity of the tax depend upon what the Court concludes the legislative intent to have been, see Note Vol. 30, Columbia Law Review, page 92 at 100. This view expressed in the Mac Allen case seems to be repudiated in the Pacific Company case.

The next case in importance cited by plaintiffs is, Gillespie v. Oklahoma, 257 U. S. 501. In Burnet v. Coronado Oil & Gas Company, 285 U. S. 393, at page 398, the Supreme Court says: 'We are disposed to apply the doctrine of Gillespie v. Oklahoma (257 U. S. 501) strictly and only in circumstances closely analogous to those which it disclosed.'

It is well settled that tax exempt federal, or other bonds are not exempt from state or federal inheritance tax. Plummer v. Coler, 44 L. Ed. 998; Blodgett v. Silberman, 277 U. S., 1; Greiner v. Lewellyn, 66 L. Ed. 676. In Peck v. Lowe, 62 L. Ed. 1049, it is held that income from shipping goods to foreign countries and there selling them may be taxed, notwithstanding the constitutional provision that 'No tax or duty shall be laid on articles exported from any state. In Flint v. Stone Tracy Company, 220 U. S. 107, recognized as authority in the Mac Allen case and expressly reaffirmed in the later Pacific Company and Educational Films Corporation cases, it is held that an excise tax on corporations may include income from tax exempt securities. Earlier cases upholding state franchise taxes measured by net property or income including tax exempt bonds or their income are: Society v. Coite, 18 L. Ed., 897; Provident Institute v. Massachusetts, 18 L. Ed., 913; and Home Ins. Co. v. New York, 33 L. Ed., 1025. In U. S. Glue Co. v. Town of Oak Creek, 247 U. S. 321, it is held that a state income tax is valid even though it includes net income derived from transactions in interstate commerce where there is no discrimination against such income.

For the foregoing reasons it is accordingly by the Court Ordered, Adjudged and Decreed that the assessment herein

appealed from is hereby affirmed and upheld and the plaintiffs' appeal therefrom is hereby dismissed and the additional assessment against the plaintiffs, Henry O. Hale and Elizabeth C. Hale, in the sum of $1387.24, hereby stands affirmed. Costs of this case are to be taxed by the Clerk to said plaintiffs."

There is little that could be added to the foregoing carefully prepared opinion of the able trial court. We have carefully examined the authorities cited and read the able arguments of counsel for appellants. We understand their position but are unable to subscribe to the proposition that a general income tax law imposed upon the entire income is a property tax. This court held in the case of City of Dubuque v. Northwestern Life Ins. Co., 29 Iowa, page 9, decided in 1870 that gross income was not property within the meaning of the law authorizing the city to collect taxes upon "taxable property." The court said: "It certainly can not be claimed that the gross income of individuals or corporations from any business in which they may be engaged for a specified period without regard to the money or property realized and on hand at the expiration of the time can be properly described by the term property. No one will pretend that the sum shown as the footing of the debit side of the merchant's cash book, during a year's business, can be called property. The money represented by each item of the account when in his possession was property, but the aggregate of the whole amount of money passing through his hands for a year could not, *at the end of that time,* when he possessed a small portion of it, be called his property." Neither can we subscribe to the appellants' contention that the law exempting the bonds themselves from taxation likewise exempts the interest, or that the inclusion of the income or interest from the bonds in the total of the gross income of the individual under the income tax law is a tax upon the bonds themselves. It is only fair to assume that the legislature at the time of the enactment or re-enactment of the tax exemption statutes relied upon by appellants was advised of the prior holdings of this court to the effect that the tax exemption laws in this state had been construed by this court as having ref-

erence to general property taxes only, and would have therefore specifically broadened the tax exemption provisions subsequently enacted to include taxes other than general property tax, if such was the intention of the legislature. Not having done so, we are not, under the rule of strict construction applied to tax exemption laws, permitted to enlarge the meaning which the legislature undoubtedly must have intended, and to extend the tax exemption statute to include the interest as well as the bonds themselves. Since the total of a person's entire income over the taxing period is not considered property, as that term is used in the statutes relating to the imposition of taxes upon property, real and personal, and since the tax exemption statutes have reference to a general property tax, which is the construction this court has always placed upon such statutes and of which we must assume the legislature took cognizance, it necessarily follows that the contractual immunity from taxation applicable to the bonds themselves was not intended by the legislature to be extended to include the interest on the bonds or to include a tax other than a general property tax. Neither can we agree with counsel that the tax was imposed "solely because of the ownership of said bonds." There is much more than mere ownership involved in looking after an investment of three quarters of a million dollars, collecting and reinvesting some $36,000 interest thereon annually. In addition to this they had other securities as well as their farming interests. It required labor, thought, energy, all of which is included with title and ownership in husbanding the large fortune, measured by the holding of the average family, which appellants had accumulated under the beneficent laws and protecting care of their government.

The decree of the trial court is therefore affirmed.

Affirmed.

Richards, C. J., Anderson, Parsons, Stiger, Donegan, J. J. concur. Mitchell takes no part.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1936.

No. [redacted] 16

HENRY O. HALE AND ELIZABETH C. HALE,
Appellants,

vs.

THE IOWA STATE BOARD OF ASSESSMENT AND REVIEW, *Appellee.*

APPEAL FROM THE SUPREME COURT OF THE STATE OF IOWA.

APPELLANTS' BRIEF AND ARGUMENT.

DENIS M. KELLEHER,
WILLIAM L. HASSETT,
ALAN LOTH,
Counsel for Appellants.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1936.

No. 832.

HENRY O. HALE AND ELIZABETH C. HALE,
Appellants,

vs.

THE IOWA STATE BOARD OF ASSESSMENT AND REVIEW, *Appellee.*

APPEAL FROM THE SUPREME COURT OF THE STATE OF IOWA.

APPELLANTS' BRIEF AND ARGUMENT.

THE OPINION BELOW.

The opinion below is not yet officially reported. It appears on page 7 of this Record and in 271 Northwestern Reporter 168.

THE JURISDICTION.

Appellants have complied with Rule 12, par. 1; and this court has noted probable jurisdiction of this appeal.

STATEMENT OF THE CASE.

Various Iowa statutes enacted in and since 1909 provide that bonds issued by the state, or its municipalities, schools and counties either "are not to be taxed", "shall not be taxed", or "shall be exempt from taxation". (R. 6, 7).

In the years after these statutes were enacted, appellants purchased about $750,000 of these tax-exempt bonds, (R. 9, 14).

After such purchases, and in 1934, Iowa enacted a "Personal Net Income Tax" statute, which was construed by the courts below to embrace the interest from appellants' tax-exempt bonds. (R. 20, 21). The question is whether this impairs the contract of exemption, contrary to Article I, sec-10 of the Federal Constitution.

Appellants are individuals. They engage in no trade or profession. They hold no franchise, corporate or otherwise. It was stipulated:

> "4. That all of said interest accrued and was paid to the plaintiffs (appellants) * * * solely because of their ownership of said bonds" (R. 14).

Appellants' tax return stated that they had no business or occupation, but were farm owners and investors (R. 9). The Iowa court accepted this statement, and found that their "business"—if it can be called such "in the broadest sense of the word"—was "that of looking after their farming interests and investing their capital" (R. 20).

Aside from the interest in these bonds, appellants had no taxable income. Their rents and other interest was less than the deductions allowed them (R. 9, 10). The respondent Board ruled that this interest was taxable income, and assessed an income tax based wholly upon it (R. 10).

Appellants properly challenged this assessment: first by application to the Board for its abatement, next by appeal to the *nisi prius* court, and finally by appeal to the state supreme court (R. 8, 11, 15, 16, 19).

ERRORS TO BE URGED.

All three errors will be urged. They present a single contention: that it was error to hold that the Iowa Income

Tax Law, construed to embrace interest from these tax-free bonds, did not impair the contract of exemption inhering in them, and thus violate Article I, sec. 10 of the federal constitution.

SUMMARY OF THE ARGUMENT.

The argument may be summarized as follows:

1. The statutory exemption is contractual within the protection of the federal constitution.

2. The scope of the exemption, and whether this tax violates it, are for this court to determine independently.

3. The lower court held that the exemption applies only to property taxes. Even assuming this, an income tax on interest derived from securities is in practical incidence and effect a tax upon the securities; and so a property tax within the exemption contract.

4. But the contractual exemption is not confined to property taxes; it forbids any tax on the bonds, including this tax on their interest, which has always been held a tax on the bonds.

(a) The exemption is broad and general, and cannot by construction be narrowed to exclude only one sort of tax on the bonds.

(b) The exemption cannot be construed thus narrowly in order to save the constitutionality of the later income tax statute.

(c) Previous Iowa cases do not justify construing the exemption to permit the present tax.

5. The exemption is violated whether or not income is said itself to be "property", for this tax still taxes the bonds.

(a) *City of Dubuque v. Northwestern Life Ins. Co.*, 29 Iowa 9 does not involve nor apply to our question, and refused to decide it.

(b) Decisions as to whether a graduated income tax

is forbidden by state constitutions, requiring property taxes to be uniform do not apply here.

6. The exemption cannot be avoided by treating the tax as "in the nature of an excise".

(a) Even an excise on receiving income under a pre-existing contract impairs the obligation of that contract.

(b) There is no excise here, for appellees exercise no taxable privilege which can be the subject of an excise, or of any other tax than one in the nature of a property tax.

(c) The things said below to show appellants "engaged in business" are simple acts of ownership, not taxable as privileges, and a tax because of them is a tax on property-ownership and not an excise.

(d) The statute does not pretend to impose an excise or privilege tax.

7. Calling the tax one on the recipient of income rather than on the income does not avail.

(a) Taxing one because of ownership of property or receipt of such income as this is tantamount to taxing the property or its income.

(b) This tax is explicitly imposed on the income as well as on the recipient.

8. *MacAllen v. Massachusetts* and *Gillespie v. Oklahoma* have not been overruled or made inapplicable by any subsequent decisions of this court. The cases thought to overrule them actually uphold them; and show that whenever the tax is (as here) an income tax rather than a tax upon corporate franchises, it may not include income from exempt securities.

9. *People v. Gilchrist* does not permit this tax or control this case.

10. The power of the state to levy income taxes does not permit it to invade our rights by imposing this tax upon us.

ARGUMENT.

The Exemption Was Contractual.

Section 1304 of the Code of 1897, as amended by the parts in italics in 1909 and 1915, provided:

"The following classes of property are not to be taxed:

1. The property of the United States and this state; * * * *municipal, school and drainage bonds or certificates hereafter issued by any municipality, school district, drainage district or county within the State*"—Iowa Code Supplement of 1915, Sec. 1304.

The words "hereafter issued" refer to 1909. (Acts 33 G. A. Ch. 81, p. 75).

In 1921, the Legislature authorized issuance of Soldiers' Bonus Bonds by the State, and provided that:

"* * * all bonds issued hereunder shall be exempt from taxation"—Acts 39th G. A. Ch. 332, Sec. 10.

In 1919, the Legislature authorized the issuance of bonds and certificates for highway construction, and provided:

> "Bonds and road certificates (whether issued in anticipation of special assessments or in anticipation of annual allotments of the primary road fund) shall not be taxed"—Acts 38th G. A. ch. 237, sec. 38.

The latter statute in the same section also provided that:

> "The rate of interest which each bond shall bear shall not exceed five per cent per annum * * * and the county treasurer shall * * * advertise and sell * * * said bonds for the best obtainable price, not less than par plus all accrued interest".

The other bonds had a maximum interest rate and a minimum selling price fixed by similar statutes: Code of Iowa (1935) sec. 4407, 1175, 5298. Appellants purchased their bonds under these statutes, and the lower courts properly treated these exemptions as contractual (R. 22). So

we need not elaborate the settled rule that where a State makes such securities nontaxable, the exemption inheres in the contract made with subsequent bond buyers. Iowa has contracted not to impose a tax. On the strength of that contract, it sold low-yield bonds for par, or more. Obviously, a tax within the purview of the exemption unconstitutionally impairs the contract:

MacAllen v. Massachusetts, 279 U. S. 620 at 634;
Murray v. Charleston, 96 U. S. 432;
Merchants Insurance Co. v. Newark, 54 N. Y. L. 70, 23 Atl. 305;
Re Assessment of First National Bank, 58 Okla. 508, 160 Pac. 469;
Pacific Railway v. Maguire, 20 Wall. 36;
Choate v. Trapp, 224 U. S. 665;
Farrington v. Tennessee, 95 U. S. 679;
Humphrey v. Pugues, 16 Wall. 326;
Cooley 'Taxation', pp. 355, 356;
26 Ruling Case Law 92.

This Court must Determine independently The Scope of the Exemption And Its Violation.

The question is whether a personal income tax on interest derived solely from mere ownership of exempt bonds violates the above contract of exemption. Its solution involves construing the contractual exemption, and determining whether the tax is of such a kind as the exemption forbids. The State Court held that the exemption applied only to property taxes, and that the income tax was in the nature of an excise, and not a tax on property.

In reviewing this decision, this court must determine independently the scope of the contract, and whether the later statute does impair it. The State Court's decision on these cannot be conclusive on this.

"* * * it is the duty (of the Supreme Court of the United States) to determine for itself the existence, construction and validity of the alleged contract, and also

to determine whether, as construed by this court, it has been impaired by any subsequent legislation to which effect has been given by the court below"—*Columbia Railway Gas & Electric Co. v. South Carolina*, 261 U. S. 236 at 245.

"It is a well established doctrine that where the contract clause is invoked this Court must determine for itself the nature and effect of the alleged agreement and whether it has been impaired"—*United States Mortgage Company v. Mathews*, 293 U. S. 232 at 236.

To the same effect are:

Detroit United Railway v. Michigan, 242 U. S. 238 at 249;

Louisana Railway v. Behrman, 235 U. S. 164 at 170.

Other cases applying this rule to reverse a construction by State Courts of tax exemptions and tax laws, appear hereafter.

Where Bonds are exempt from taxation, a tax on their income is really a tax on the property in them, and violates the contractual exemption.

The contract is that these bonds "are not to be taxed"; that they are "exempt from taxation". The lower courts say this means that no property tax can be imposed respecting them. Even this must forbid a levy whose practical effect is to tax them, or whose incidence is on a property right inhering in them. An exemption from property taxes is not too narrow to forbid this income tax. The case cannot depend on the mooted abstract question whether income taxes, *generally* are property taxes, excises, head taxes, or taxes *sui-generis*. It must depend on the practical result of *this* tax upon these appellants and these bonds. If the tax is here essentially one on property-ownership, it is forbidden by an agreement against property-taxation. Whether

the tax infringes on the exemption must depend on its practical incidence and effect:

> *Home Insurance Co. v. New York*, 134 U. S. 594; *Dawson v. Kentucky Distillers Co.*, 255 U. S. 288 at 292.

The tax cannot

> "be placed in a class different than that to which its practical results consign it. Taxation is eminently practical * * * and, for the purpose of deciding upon its validity, a tax should be regarded in its actual practical results rather than those theoretical or abstract ideas the correctness of which is a subject of dispute"—*Knowlton v. Moore*, 178 U. S. 41 at 83.

> "It appears sufficiently from what has been said that we are to look for the practical, rather than the logical or philosophical distinction. * * * Neither the state courts nor the state legislatures, by giving the tax a particular name, or by the use of any form of words, can take away our duty to consider its nature and effect"—Justice Holmes in *Galveston & C. Ry. v. Texas*, 210 U. S. 217.

That cases involving other sorts of incomes, or other aspects of income taxation, sometimes treat a particular income tax as an excise does not mean that this tax can here be so treated. Taxes on incomes *not* derived from mere ownership of property may well be so far removed from property-ownership as not to amount to a tax thereon. But the sole question here is as to the practical nature of a tax on *our* income, received "solely because of the ownership" of contractually exempt bonds. On principle and authority, such an income tax is a tax on the bonds within the purview of a contract not to tax them. It is the substantial equivalent of a tax on them, or respecting them, as property.

This tax was imposed only because appellants received interest inuring to them from the bare fact of their owner-

ship of these bonds. It seems self-evident that when Iowa promised not to tax the bonds, that fairly meant no tax would be imposed because of, or impinging upon, their ownership. The state could not evade that contract by taxing the owners because they own the bonds. Thus, it was conceded in argument below that a poll tax measured by the amount of tax-exempt bonds owned by each citizen would violate the contract not to tax the bonds, because that would be its only practical result or effect. The Iowa credits tax is 6 mills: $6 per bond. The Iowa income tax is roughly 5% of the interest: $2 per bond. If Iowa can tax us $2 per bond merely because our ownership gives us income from it, it can also tax the full equivalent of the $6 credits tax, or even more. In either case, there is nothing on which to base the levy save the fact that we own bonds. But the state promised not to tax that ownership. Even a promised exemption of the bonds as "property" must mean the exemption of the whole property in them, and all its attributes or parts. Taxing income received from the bare ownership of bonds, which accrued solely as an attribute and result of that ownership, has the same practical actual effect as taxing the bonds. Indeed, the income is the *only* practical attribute of property in such bonds. To tax it essentially taxes the bonds. The bondholder cannot use or consume his bonds; all he buys is the income from them; and taxing that income taxes the thing of substance which he has purchased. The income thus received is the essential, distinctive feature of appellants' property in these bonds; the only thing which gives them value or substance. If you can promise a man not to tax bonds he buys from you, and then tax him solely because he receives the income thus purchased, the promise is illusory and unreal. Promises are not thus construed. Similar practices by a private individual would be not only breach of contract, but would have the swift attention of those officials supervising deal-

ing in securities, as fraudulent. In the most obvious, direct and practical sense, a tax on the income received "solely by virtue of ownership" of such bonds is a tax on the property in them.

We shall later show that there is no other taxable subject than the property in these bonds to which this tax can be ascribed: no transaction to tax; no occupation to tax; no franchise or privilege to tax; nothing to tax but an essential attribute of bond-ownership. This demonstrates that the tax is actually a tax on the property in the bonds, for to tax a man solely because of his ownership of property is to tax the property.

The uniform decisions of this court have long made it law that, if for any reason property is immune from taxation, an income tax imposed with respect to income received solely because of its ownership violates the exemption, because that is its practical result. Oklahoma once imposed an income tax on income from exempt oil leases, which this court held void in *Gillespie v. Oklahoma*, 257 U. S. 501, because a tax on income derived wholly from ownership of exempt property was, as regards the exemption, essentially a tax on the property. The court said in part:

> "In case where the principal is absolutely immune from interference, an inquiry is allowed into the sources from which the net income is derived; and if part of it comes from such source, the tax is *pro tanto* void (*Pollock v. Farmers Loan & Trust Co.*, 157 U. S. 429, 158 U. S. 601)—a rule lately illustrated by *Evans v. Gore*, 253 U. S. 245, and applied to a case somewhat like the present by the Supreme Court of Hawaii (*Oahu R. & Land Co. v. Pratt*, 14 Hawaii 126). * * * The same considerations which invalidate the tax on such leases invalidate a tax upon the income from such leases."

MacAllen v. Massachusetts, 279 U. S. 620 holds that a state cannot levy an income tax so as to include interest from bonds which it has made tax-free. The Massachusetts

exemption statute was like ours: providing that "the following property and polls shall be exempt from taxation", and then listing certain classes of persons and certain classes of property, the latter including municipal bonds. The state later passed a corporation income tax law. Its courts held that this was not a property tax, but an excise on the privileges of holding a corporate franchise. (The Iowa Personal Net Income Tax cannot be claimed to be an excise of the privilege of holding a corporate franchise, for it applies only to individuals). This court held the Massachusetts tax was not a franchise tax, but merely a net income tax. Having determined that it was only an exaction on the taxpayer in respect of his income, this court held it could not constitutionally include income derived from bonds the state had previously made tax-free. After first finding the tax was "in reality a tax on incomes derived from tax-exempt securities", the court denied the claim that a tax on the interest was not a tax on the bonds, saying:

> "It is impossible to conceal from ourselves that this is varying the form, without varying the substance. It is treating a prohibition which is general, as if it were confined to a particular mode of doing a forbidden thing. * * * If * * * this is the real purpose and effect of the legislation, the tax cannot be upheld without subverting the well established rule that what cannot be accomplished directly because of a constitutional restriction, cannot be done indirectly by legislation which accomplishes the same result. * * * Constitutional provisions, whether by grant or limitation, are to be enforced according to their letter and spirit, and cannot be evaded by any legislation which, though not in terms trespassing on the letter, yet in substance and effect destroy the grant or limitation."

The court concluded that the income tax statute

> "in substance and effect imposes a tax on * * * the county and municipal bonds. * * * The act is void. * * *

> The act impairs the obligation of the statutory contract of the state by which such bonds were made exempt from taxation."

The lower courts obviously recognized they could not uphold the present tax in the face of these decisions; but thought they had been overruled (R 26). The decisions said to overrule them will be later analyzed. We now only say that they have not been overruled, but are only two of many decisions that an income tax cannot include income derived solely from exempt property, for to that extent it is a tax on the property. *Northwestern Mutual Life Ins. Co. v. Wisconsin,* 275 U. S. 136 at 140 holds a State Income Tax on tax-exempt bonds is void as being a tax on the bonds, saying:

> "Certainly, since *Gillespie v. Oklahoma,* 257 U. S. 501 it has been the settled doctrine that where the principal is absolutely immune, no valid tax can be laid on the income derived therefrom. To tax this would amount practically to laying a burden on the exempted principal. Accordingly, the challenged act, whatever called, really imposes a direct charge on the interest derived from * * * bonds, and is *pro tanto* void. * * * This amounts, we think, to an imposition on the bonds themselves, and goes beyond the power of the state."

National Life Insurance Co. v. United States, 277 U. S. 508, involving income taxes on interest from tax-free securities, also holds:

> "One may not be subjected to greater burdens on his taxable property solely because he owns some that is tax free. No device or form of words can deprive him of the exemption for which he has lawfully contracted. * * * It is settled doctrine that directly to tax the income from securities amounts to taxation of the securities themselves."

Pollock v. Farmers Loan & Trust Co., 157 U. S. 429, distinguished between taxing incomes derived from trades or

professions, and those derived wholly from ownership of property. It held that while taxing the former kind of income might be deemed an excise or occupation tax on the privilege of engaging in the trade or profession, this could not be said of a tax on incomes of the latter class, and that:

> "(page 558) * * * a tax upon property-holders in respect of their estates, whether real or personal, or of the income yielded by such estates, and the payment of which cannot be avoided, are direct taxes. * * * (page 581). In *Weston v. Charleston*, 27 U. S. 449, it was held that a tax on the income from United States Securities was a tax on the securities themselves, and equally inadmissible."

On rehearing this was reaffirmed. The new opinion in 158 U. S. 601 at 613 and 637 pointed out that the decision meant that a tax on incomes from real estate and municipal bonds was a property tax on the land or bonds. This plainly holds that, whatever may result from taxing other sorts of income, income taxes respecting income derived solely from the ownership of property violate a limitation governing direct taxes on such property, and the violation cannot be escaped by the device of christening the tax an excise. Likewise, *Weston v. Charleston*, 27 U. S. 449 holds that a tax on income from exempt securities is as invalid as a tax on the securities would be. And *Pacific Railway v. Maguire*, 20 Wall. 136 holds that Missouri could not tax the income of a railroad whose property it had agreed on for the exemption, because such tax would violate the contract.

These cases had settled the law in 1909 when Iowa enacted the first of these exemption statutes. The Legislature must have known that its promise of immunity included immunity from tax on both interest and principal. *Knowlton v. Moore*, 178 U. S. 41 (on pages 52, 82, 83) had expounded the *Pollock* Case as holding that a tax on income derived from property was the equivalent of taxing the

property, and had reaffirmed the soundness of that doctrine because such was the practical effect of such a tax. After all, people contract for practical results; and it is rather astounding to the ordinary man to be told that the state which has promised not to tax his bonds, and has thus sold them at a high price for a low rate of interest, may tax that interest (or tax him for receiving it) and by such device avoid the promised result. Whether the contract is broken by an act ought to depend on the actual results of the act, and not on mere abstractions or from the form of words by which the act is authorized.

Eisner v. Macomber, 252 U. S. 189 at 205 again says the *Pollock* Case decided that income taxes on rents from land and interest from investments were, in effect, direct taxes on property, because imposed by reason of its ownership; and says such taxes are still so considered. Finally *Willicutts v. Bunn*, 282 U. S. 216 says that, though some species of income taxes may be viewed as excises, under the *Pollock* Case this is not true as to income taxes on interest from bonds, and again holds:

> "A tax on interest is levied upon the return which comes to the owner of the security according to the provisions of the obligation, and without further transactions on his part. The tax falls on the owner by virtue of the mere fact of his ownership, regardless of his use or disposition of the security."

So, if Iowa's contract was not to impose a tax with respect to the property in these bonds, it has violated the contract by taxing us on account of this interest which came to us precisely in the manner above described, and which falls on us merely by virtue of the fact of our ownership. Such a tax is surely a property tax (i. e. a tax on or with respect to property-ownership) within the fair meaning of any rational agreement not to tax the property in these bonds.

It is true that when not dealing with such contracts, or even directly with incomes received from mere property-ownership, the state courts differ as to the abstract nature of an income tax. Some language, used with respect to entirely different situations, is quoted in the opinions below (R. 24, 25). It comes from cases deciding whether a graduated income tax is forbidden by state constitutions providing that property is to be taxed uniformly. Obviously, the question as to what sort of classification keeps the requirement of uniformity, has no bearing on the present case. Where cases turn on whether a tax on our sort of income is a tax on property (even where exemption contracts are not involved), most states have agreed with this court in holding that it is. Thus 26 Ruling Case Law 142, cited below as holding an income tax is "sometimes" an excise (R. 24), actually points out this is not true as to a tax on this sort of income, saying:

> "A distinction may also be drawn between a tax on the income from property and income of a trade, profession or employment. * * * It is now generally conceded that a tax laid directly on the income of property is a tax on the property itself, in accordance with the rules laid down in the federal courts."

Some of the most recent state court decisions making this distinction and holding that an income tax on interest from securities is a property tax on the securities themselves are:

Hobart Estates v. State Board, 1 Cal. Ap. (2) 328; 36 Pac. (2) 407 at 409 (holding the state which cannot tax certain property cannot include its income in an income tax).

Kelly v. Kalodner, 320 Pa. 180; 181 Atl. 598 at 600, 601 (Holding that a tax on income from money at interest, coupled with an exemption of the principal from other taxation, is in substance and effect a property tax and must be so treated).

Jensen v. Henneford, ... Wash. ... 53 Pac. (2) 607;

Hart v. Tax Commission, 240 Mass. 37; 132 N. E. 621 at 622;
Opinion of Justices, 220 Mass. 613, 108 N. E. 570 at 574.

Section 1304 of the Iowa Code of 1897, in a separate paragraph exempted as a separate "class of property", the property of the United States. As shown by Section 1304 of the 1915 Code Supplement quoted on Page 5 above, that very paragraph exempting federal property was amended by adding *these* bonds to *that* exemption. The Legislature knew that the exemption of federal property from taxation included the income from that property; for it is settled that the income from federal property is as fully exempt from income taxes as the property is from property taxes. So when the Legislature put these bonds in the same "class of property" which was "not to be taxed", it must have intended the same immunity for these bonds as for the federal property with which they were explicitly coupled. And that immunity was from income taxation as well as other forms of property taxation.

For these reasons, we confidently assert that the original contracts of exemption forbid a personal net income tax embracing interest on these bonds which fall to the owner thereof as part of his ownership. It is self-evident that the present tax is claimed against us wholly by virtue of such interest. That such interest accrued to and was received by us solely by reason of our ownership of the bonds is a stipulated fact (R. 14), and would be obvious if it were not. Upon these considerations, and under these authorities, the tax must amount to a property tax which all agree is forbidden by the statutory contracts of exemption.

The Contract Cannot Be Construed To Permit This Income Tax Even Though It Is Not A Property Tax.

The statutory contract does not rigidly limit the exemption to "general property taxes". This is not its language. A contractual exemption "must not be read so grudgingly as to thwart the intent of the lawmakers"—*Trotter v. Tennessee*, 290 U. S. 354. This exemption enabled the state to sell its bonds more easily, at higher prices and lower interest. That object could only be attained by a broad immunity; and would be frustrated if the state was understood to reserve the right to impose new forms of taxes. Therefore, broad language is used. The bonds, as a "class of property", are put with federal property, to be equally immune from taxes. That language, given full effect, cannot be limited to "general property taxes", if that means merely millage taxes. It is breached by whatever amounts to a tax on the bonds, however named or evolved. It should not be capable of avoidance by cauistry or indirection. So, if the courts' limitation of it to "general property tax" permits this income tax, it is wrong so to limit the exemption.

It is admitted that a tax on persons levied annually upon and in respect of their tax-exempt bonds would violate the exemption. It would not then be said the tax was on the recipient of the bonds and not on the bonds. The previous argument shows that an income tax on this interest is a tax on the bonds. That showing cannot be avoided by arguing whether the income tax is a general property tax or not. So it cannot be justified by saying, as below, that an income tax is "on the recipient of the income rather than on the income as a thing" (R. 24). Whether nominally laid on the recipient or the income (and the words of our statute put it *on both*), it is a tax on the bonds, even if it is not a "general property tax."

MacAllen v. Massachusetts, 279 U. S. 620, rejected the contention that an income tax on interest was not a tax on

the bonds. It said the contractual exemption was impaired by a tax that "is in substance and reality a tax on the income derived from tax-exempt securities", and that any such distinction

> "is varying the form without varying the substance. It is treating a prohibition which is general as if it were confined to a particular mode of doing a forbidden thing."

That statute simply exempted certain sorts of property, including municipal bonds, from taxation. This court held that including their interest in an income tax violated that statutory contract. It must be equally true here that the prohibition is general, and cannot be treated as if it were confined to "general property taxes". It forbids *all* taxes on the bonds.

Our statute does not say merely that the bonds should not be taxed by any levy then in vogue, or except by taxing their income. A Tennessee statute once said that banks should pay a certain tax in lieu of all other taxes. Later Tennessee evolved a new sort of tax, which was applied to banks on the theory the exemption was only from the taxes in vogue at its adoption. This court held the statutory contract could not be so narrowly construed:

> "The state might have been silent as to taxation. It might have reserved the power as to some things and yielded it as to others. It had power to make its own terms. It chose to stipulate for a specified tax, and declared and bound itself that this tax should be 'in lieu of all other taxes'. * * * But the state has, by its revenue law, imposed an additional tax. * * * This is one of the other taxes it stipulated to forego. * * * There is no reservation or discrimination as to any 'other tax'. All alike are included. Such is the natural effect of the language used. The most subtile casuistry to the contrary is unavailing. Under such a contract between individuals, no doubt could have existed. * * * We cannot so hold without interpolating into the statute a clause

> which it does not contain. * * * If it was intended to make an exception to the universality of the exemption, it would have been easy to say so, and it is presumed this would have been done. In absence of any such expression, we can find no evidence of such intent. Our view is sustained by the leading authorities on the subject"—*Farrington v. Tennessee,* 95 U. S. 679.

So here, Iowa contracted not to tax the bonds. This contract cannot be narrowed by permitting it to tax them in actuality, even by something not a general property tax. It must mean that it cannot tax them at all, by any tax, directly or indirectly; for:

> "If this is the real * * * effect of the (tax), it cannot be upheld without subverting the well established rule that what cannot be accomplished directly cannot be done indirectly by legislation which accomplishes the same result"—*MacAllen v. Massachusetts,* 279 U. S. 620.

That, and all other cases in this court, hold that an income tax on interest from exempt property violates the exemption. The abstract classification of an income tax as being a general property tax or something else is wholly immaterial. It does tax the bonds,—though they "are not to be taxed". Beyond that, we are not concerned.

The lower courts thought they could thus narrowly construe the exemption because the exemption statute "must, if fairly possible be construed to save the constitutionality of *the income tax law*" (R. 22). That is not true. The income tax law must be construed to save its own constitutionality; and so we contended below it ought not to be construed to embrace this kind of interest. Such construction was refused, though it would have prevented any question of the law's constitutionality. It is wholly improper to construe the exemption law so as to sustain a statute passed 25 years

later. An early statute cannot be construed with, or in view of, a later one; even for such a purpose:

Worthen v. Kavanaugh, 295 U. S. 56.
Hoffman v. Quincy, 71 U. S. 535 at 554.

"The legislative history of an act may * * * be resorted to as an aid to construction. * * * But no aid could possibly be derived from the legislative history of another act passed nearly six years after the one in question"—*Penn Mutual Life Insurance Co. v. Lederer*, 252 U. S. 528.

"The intention of the 50th General Assembly, which passed the act of 1917 cannot be determined by the intention of the 55th General Assembly. * * * Past or concurrent legislation in *pari materia* may be considered in construing a particular statute, but not subsequent legislation. If this were true, the same law might have a different meaning with each passing General Assembly"—*People v. Central Illinois Public Service Co.*, 328 Ill. 440, 159 N. E. 797.

So, the statutory contract cannot be construed to fit a law later passed. Our rights, complete before the income tax law was enacted, cannot be narrowed by fitting them to the very law which impairs them. Their original scope must be preserved without regard to the impairing statute—*Appelby v. New York*, 271 U. S. 364 at 380, and citations therein.

"Legislative contracts are to be read in the light of the policy and purpose at the time they are made, and cannot be changed at a later period when different ideas and theories may prevail"—*Re Assessment of First National Bank*, 58 Okla. 508; 160 Pac. 469; *Mobile & Ohio Ry. v. Tennessee*, 153 U. S. 486.

Never before had Iowa construed this exemption. It had only construed other exemptions contained in section 1304 of the 1897 Code; those exempting municipal property, and property of certain insurance corporations. Those decisions are cited below as authority for saying this exemption is limited to general property taxes (R. 23); but they do not

so hold. None involve income taxation, nor contractual exemptions of any sort.

Sioux City v. School District, 55 Iowa 150, 7 N. W. 488, and *Edwards v. Jasper County*, 117 Iowa 365, 90 N. W. 1006, hold the statute exempting municipal property does not apply to a special assessment for street improvements, because such assessment is not a tax at all, but a payment for a special and direct benefit. These are the only cases even using the phrase "general property tax", and they use it only in contradistinction to a special assessment.

State v. Des Moines, 221 Iowa 642; 266 N. W. 41, holds that the same exemption does not prevent collection of an excise tax on gasoline laid on the privilege of using the state roads. This case does not even say that the exemption of municipalities applies only to general property taxes, but only that it

> "does not apply to privilege taxes * * *. The * * * tax is not a general tax for general purposes, but an excise in the nature of a privilege tax."

The present tax *is* a general tax for general purposes, being created expressly to displace and reduce the payment of general property taxes. Code of 1935, Sec. *6943-f2* says so:

> "This chapter shall be known as the 'property relief act', and shall have for its purpose the direct replacement of taxes already levied or to be levied on property to the extent of the net revenue obtained from the taxes imposed herein, which shall be apportioned back to the credit of individual taxpayers on the basis of the assessed valuation of taxable property as provided in division VI of this chapter."

No contractual or constitutional questions are involved in these former Iowa cases. The municipality there affected is but an arm of the state, not protected by constitutional immunities of citizens, without right to complain of the

repeal or alteration of any state statute affecting municipal property:

Scott County v. Johnson, 209 Iowa 213, at 221, ff; 222 N. W. 378;
Clinton v. C. R. & C. Ry., 24 Iowa 445 at 475;
Herrick v. Cherokee County, 199 Iowa 510; 202 N. W. 252.

Iowa Mutual Insurance Co. v. Gilbertson, 129 Iowa 658, 106 N. W. 153, only holds that exempting property of an insurance company does not forbid collecting a privilege tax for the use of its corporate franchise. No contractual or constitutional question existed there.

The opinions (R. 21) also cite *Appeal of Van Dyke*, 217 Wis., 528, 259 N. W. 700, as holding the exemption does not forbid an income tax. No constitutional or contractual questions were involved there. Wisconsin had never granted any previous exemption of municipal bond. The legislature which enacted one also included interest in the general income tax. The Wisconsin court, construing the acts of the same session in *pari materia*, and for other reasons here not pertinent, held the Income Tax Law included interest on these bonds. The validity of such construction was not questioned, and could not have been; for there were no bonds issued before the income tax law was passed which could have been impaired by it. This case may be authority for construing the Iowa Income Tax Law to include this interest; but it has no bearing whatever on the question now before this court.

The Exemption Is Violated Whether Or Not Income Is "Property".

The lower Courts also suggested that income is not property, and a tax on income is not a tax on property (R. 24, 27, 28). If we are right in saying the exemption cannot be confined to property taxes as such, this is not very impor-

tant. But even if the exemption is only from property taxes, income from property is property within the exemptions, whether other sorts of income are or not. This is shown in a preceding division of this argument. The cases cited below do not involve or rule on this question. The only Iowa case mentioned is *City of Dubuque v. Northwestern Life Insurance Co.*, 29 Iowa 9 (R. 27). The court there refused to pass on whether or not the tax involved impaired a contract (See 29 Iowa pp. 1, 12), and said the only question was:

> "Are annual receipts of the insurance company * * * property *upon which the city* may levy and collect taxes? * * * if sustained at all it must be under the authority of the city to collect taxes on 'taxable property'."

The court noted the city had no authority to determine what should be "taxable property" (29 Iowa p. 12). The reason was that the legislature had determined that as follows:

> "All taxable property shall be taxed each year, and personal property shall be listed and assessed each year in the name of the owner thereof *on the first day of January*"—Code of Iowa 1873, sec. 812.

The right of the city to levy this tax did not depend on whether income was property, but on whether it was "taxable property" within the city on January 1, 1868, the date when property had to be owned by the taxpayer, and be in the city to be taxable. This income had not then been received. The case only decided that Dubuque could not claim such income was "taxable property" *on January 1, when its levy must be made.* Also, it did not involve income from property; only income from the insurance business. It does not hold that income from property is not property, much less that the interest from tax-exempt bonds can be taxed without infringing the exemption. If it did,

it is clearly conflicting with the decisions of this court, whch must control.

The other cases cited as holding that income is not property do not deal with income such as ours: i. e. interest from bonds or income from the ownership of property. As the trial judge pointed out, they are all cases determining whether a state constitution requiring property to be taxed uniformly forbids a graduated income tax (R. 24). Such cases fall into two classes: (1) those like *State v. Nichols,* 66 N. D. 355, 265 N. W. 859, holding that if income be property, large incomes can be classified differently from small ones, and uniformity is attained if each class is taxed uniformly; and (2) those from Massachusetts and Illinois holding income is property and such graduated taxes are forbidden by these provisions, and (3) those like *Featherstone v. Norman,* 170 Georgia 370, 153 S. E. 58, which hold that the word "property" is not used in those constitutional provisions in the same sense that it is in exemption statutes, and does not include income because that would defeat its manifest purpose in the light of the constitutional history. The *Featherstone Case* recognizes that *MacAllen v. Massachusetts,* 279 U. S. 620, forbids income taxes on tax-free interest, but says the word "property" is used in a different sense in the state constitution. Manifestly, only the last cases are even remotely important here, and they differ from this because: (a) they do not involve the difference between income derived solely from property and incomes not so derived; (b) they do not involve contracts, or the contract clause of the constitution; (c) they do not involve taxpayers whose money the state has taken, or who have done any act relying on a tax exemption; (d) the purpose and history of the constitutional requirement is so different from the purpose and history of this exemption contract that it affords no fair criterion by which to measure the exemption from taxation.

With these cases we may also group the recent opinion of this Court in *New York v. Graves*, 81 Law Ed. Adv. Op's. 409, filed March 1, 1937.

It merely held that the Fourteenth Amendment did not forbid a state taxing its own citizens on income from lands in other states or bonds secured by such lands. The sole question was said to be whether the due process clause forbad this tax; and the decision merely was that

> "it would be pressing the due process clause * * * too far to say that because a state is prohibited from taxing lands it neither protects nor controls, it is likewise prohibited from taxing the receipt and command of income from this land by its resident, who is subject to its control and enjoys the benefit of its laws."

The due process clause is concerned only with a tax imposed without jurisdiction to tax—without any foundation in returns given the taxpayer by the taxing state or in ability to control the property taxed. The decision merely was that taxing jurisdiction sufficiently appeared.

But the decision recognizes that, under other constitutional provisions, having objects different from the due process clause, such tax is forbidden. The *Pollock case* is said to hold that such tax is so far direct as to be within the purview of constitutional provisions governing direct, rather than excise taxes. "By a parity of reasoning" the immunity of income-producing instrumentalities of one government against taxation by another is extended to its income, because the income tax essentially burdens the property. By like "parity of reasoning", as well as by the authorities on which we rely, this tax is essentially a tax on our bonds within the fair purview of a contract not to tax them, and the contract clause of the constitution protecting such contract.

The basis for the *Graves* decision is that the taxpayer enjoys governmental protection and benefit from the tax-

ing state as to his income which that state does not give him as to his property. There is no such basis for the tax here involved. Iowa agreed not to tax these bonds; and to permit a tax because of their ownership within its borders and the governmental protection thus incidentally afforded them would palpably violate the agreement not to tax them at all.

Under the decisions noted in a prior division of this argument, this income tax is a tax on the bonds; and that suffices to bring it within the limitation which the state, for value received, placed on its power to tax these bonds.

The state can repeal the exemption and tax its bonds thereafter issued. But it cannot repeal the exemption as to our bonds issued under it. It can stop the exemption by paying the bonds; but not by leaving them outstanding and taxing their interest on any refined theory that taxing interest is not taxing the bonds or the property in them.

The Tax Cannot Be Treated As An Excise To Avoid The Exemption.

Appellees' sole contention below was the tax escaped the exemption because it was an excise (R. 29, 30).

But there are many kinds of excises. Even an excise may be so laid upon the bonds as to impair the contract:

Coolidge v. Long, 282 U. S. 582 at 595;
Tax Commission v. Rife, 119 Ohio St. 83; 162 N. E. 390;
Re Morrison's Estate, 224 N. Y. S. 346.

The courts below did not "fully adopt the defendants' contention" (R. 22), but did treat the tax as analogous to an excise (R. 24, 26). Still more easily can a tax merely analogous to an excise violate a contract not to tax the bonds.

The language of the Iowa Income Tax Law does not make it an excise. So far as material, that statute is found in

sections 6943-f4 to 10 of the Iowa Code of 1935, which read as follows:

> "Division II. Personal Net Income Tax.
>
> "6943-f4. * * * the word 'resident' applies only to individuals. * * * The word 'individual' means a natural person. * * *
>
> "6943-f5. A tax is hereby imposed, beginning the first day of January, 1934, upon every resident of this state, which tax shall be levied, collected and paid annually upon and with respect to his entire taxable income, as herein defined, at rates as follows (table of rates not material). * * *
>
> "6943-f7. The term 'net income' means the gross income of the taxpayer less deductions allowed by this division.
>
> "6943-f8. 1. The term 'gross income' includes gains, profits and incomes derived from salaries, wages, or compensation from personal service, of whatever kind and in whatever form paid, or from vocations, professions, trades, business, commerce, or recurring profits and income growing out of the ownership or use of or interest in property, real or personal; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit; or gains or profits and income derived from any source whatever, and in whatever form paid. * * *
>
> "2. The term 'gross income' does not include the following items, which shall be exempted from taxation under this division." (listing various items, principally capital gains; insurance; property acquired by gift or inheritance, but not income on such property; interest on federal obligations; salaries of federal officers; stock dividends).

Sections 6943-f9, 10 list allowable and unallowable deductions from gross income, the details not being material.

Since this tax applies only to individuals, it must not be confused with an excise on corporate franchises measured by income. Corporations are taxed separately under Division III of this statute (Sec. 6943-f29, *et seq.*). This is important because the lower courts cited federal cases which

are not in point because they are explicitly restricted to corporate franchise taxes.

This statute does not in terms pretend to lay an occupation tax, or a tax on the privilege of receiving income, or any other sort of excise. In this respect it is like the one annulled in *Galveston Ry. v. Texas*, 210 U. S. 217, which said:

> "This is merely an effort to reach * * * receipts, not even disguised by the name of an occupation tax."

If this is an excise as to us, it is not from its terms, but because of its effect. But it has no such effect. As to us, it lacks the distinctive features of an excise. So it cannot escape our exemption on the ground that it is in the nature of an excise.

> "Excises are 'taxes laid upon the manufacture, sale or consumption of commodities within the country, upon licenses to pursue certain occupations, and upon corporate privileges', which appears to cover the whole ground"—*Flint v. Stone Tracy Co.*, 228 U. S. 107 at 151.
>
> "We think the words ('duties, imposts and excises') were used comprehensively to cover customs and excise duties imposed on importation, consumption, manufacture and sale of certain commodities, on privileges, particular business transactions, and the like"—*Thomas v. United States*, 192 U. S. 363 at 370.

None of these things exist here, and it cannot be fairly said that this income tax is laid on any of them. There is no taxable subject separate from our ownership of these bonds. So the tax must be on the bonds, and thus a violation of the contract not to tax them. If it is not on ownership of the bonds, on what is it laid?

The authorities cited in this connection by the opinions below all involve excises on some taxable privilege; mostly the privilege of a corporate franchise. But what privilege do these appellants exercise which can be the subject of a

tax? Before the tax can be a privilege tax, there must be a privilege for it to tax.

> "A privilege tax * * * is imposed on the right to exercise a privilege, and its payment is invariably made a condition to the exercise of that privilege"—*Ingels v. Riley*, 5 Cal. (2d) 154; 53 Pac. (2) 939 at 942.

This statute grants no privilege, mentions none, and exacts payment for none. We exercise none. Appellants have no profession or trade on which to levy an occupation or license tax. They merely hold land and bonds, and receive interest from these bonds "solely because of their ownership". The Iowa Supreme Court suggest that appellants engaged in business "in the broadest sense of that term" because they owned these farms and securities, and thus occupied "the status of investors of capital"; that in view of "the energy expended in an endeavor to make the farm pay or realize returns on such investments, they might well be said to be engaged in the business of farming" (R. 19, 20). It cannot be seriously contended that this discloses anything separate from property-ownership on which any occupation, license or privilege tax can be laid. In fact, the court later said that this "required labor, thought and energy, *all of which is included in ownership*, in husbanding this large fortune" (R. 29). Thus it recognizes, perhaps unconsciously, that appellants do nothing more than own and hold property.

If our mere "status as investors of capital" is the foundation of a tax, it is on the invested property, and in the nature of a property tax rather than an excise. If we were engaged "in the business of farming", that would not warrant taxing the interest from our exempt bonds. The statute does not impose an occupation tax on farmers measured by their income from exempt bonds. Energy may be spent in husbanding the property, without any act or conduct taxable as a privilege. The opinion points to no taxable privilege;

its language indicates nothing but ordinary property-ownership, and if the tax is based on any such subject it is self-evidently a property tax.

Property-ownership is not the subject of an excise. If that be what is taxed, the tax must here be treated as on the bonds, and not an excise.

> "The individual, unlike the corporation, cannot be taxed for the mere privilege of existing. The corporation is an artificial entity, and owes its existence to the charter powers of the state, but the individual's right to live, *and to own property* are natural rights, for the enjoyment of which no excise can be imposed"—*Redfield v. Fletcher,* 135 Ore. 180, 292 Pac. 813.

> "The mere right to own and hold property such as is referred to * * * cannot be made the subject of an excise"—*Opinion of Justices,* 195 Mass. 607, 84 N. E. 499.

> "The mere right to own and hold property cannot be made the *subject of an excise,* because, to tax by reason ownership of property is to tax the property itself"—*Jensen v. Henneford,* 185 Wash. 209, 53 Pac. (2) 607 at 610.

Nothing which the Iowa court describes us as doing can be properly separated from the mere ownership of property. All owners do what they can, with the energy or ability at their command, to "husband" it. That is an attribute and concomitant of ownership; not a separate taxable subject. Basing a tax thereon is basing it essentially on ownership, and not on the exercise of any taxable privilege.

Dawson v. Kentucky Distillers Co., 255 U. S. 288, condemned a tax no further from one on ownership as being one on property and not an excise:

> "The name by which a tax is described is, of course, immaterial. Its character must be determined by its incidents; and obviously it has none of the incidents of an ordinary occupation tax. * * * It is not on the occupation of the warehouseman. The tax might be said

> to be upon the act of removal (of whisky) from the bonded warehouse. But * * * the thing really taxed is the act of the owner in taking his property out of storage. To levy a tax by reason of the ownership of property is to tax the property. * * * It cannot be made an occupation or license tax by calling it so."

If taxing the owner's removal of his goods from storage is a tax on a mere act of ownership, surely a tax justified because the owner looks after his own farms and conserves his own bonds, is also one on the mere act of ownership, and not an excise.

The obvious truth is that appellants do nothing which is a privilege at all. The things they do are matters of common right, inhering in any property-ownership; not a privilege, but an absolute right.

The only other thing which could conceivably be the subject of an excise, either as a privilege or transaction, is our receiving the interest for which these bonds provide. In a sense, such receipt is a transaction. But it is not a taxable transaction; and it certainly is not a privilege but a right. Appellants receive the income merely from the property, under the contract the state has agreed not to tax and as part of that contract, without any further transaction on their part. If the receipt of money is ever a privilege or transaction which the state may tax as such, that is not true of a payment which comes in as a matter of absolute right, under a pre-existing contract. Such a tax is essentially and actually a tax on the bonds. This is pointed out in *Willicuts v. Bunn*, 282 U. S. 216:

> "A tax on interest is levied upon the return which comes to the owner of the security, according to the provisions of the obligation and without further transaction on his part. The tax falls on the owner by virture of the mere fact of his ownership."

Such a tax cannot be an excise, for there is no privilege to tax. Receipt of property by devise or inheritance is us-

ually a taxable privilege. The lower courts thought this tax could be likened thereto (R. 26, 27). But where one has a fixed contractual right to receive money, even an inheritance tax cannot be imposed thereon, for, though an excise, if applied in such a case, it impairs the obligation of the contract. *Coolidge v. Long*, 282 U. S. 582 held that where a contract existed whereby property was to pass on the death of a person, a later inheritance tax on such transmittal—admittedly an excise—impaired the obligation of such contract:

> "The trust deeds are contracts within the meaning of the contract clause of the constitution. They were fully executed before the taking effect of the state law under which the excise is claimed. The Commonwealth was without authority by subsequent legislation, whether enacted under its power to tax or otherwise, to alter their effect or impair or destroy rights which had vested under them."

Before this Income Tax Law, appellants had the contractual right to receive this interest. The contract was fully executed. That receipt was not a privilege; and could not be taxed as such. No excise can be levied on the "privilege" of receiving payment to which the recipient is theretofore contractually entitled by a pre-existing tax-free contract. So in *Re Morrison's Estate*, 224 N. Y. Suppl. 346, a statute had exempted from taxation funds accumulated in a Teachers' Retirement Fund, which plaintiffs were entitled to receive on the teacher's death. The state later sought to impose an inheritance tax as an excise for the privilege of this transmittal. The court held there could be no excise on this transaction, because the payment came to plaintiff not as a privilege, but by absolute right, accorded by the statute governing the fund. And in *Tax Commission v. Rife*, 119 Ohio St. 83, 162 N. E. 390, Ohio attempted to collect an inheritance tax on the transmittal of war risk insurance;

but it was held impossible, because the transmittal was not a privilege but a right, the court saying:

> "The right to take this property is by virtue of a contract between the United States and the soldier, and does not arise by reason of the statutes of descent of this state."

In *Jensen v. Henneford*, 185 Wash. 209, 53 Pac. (2) 607, at 610, the state income tax law was explicitly phrased to be a tax "upon the privilege of receiving income". It was held no excise could be laid, as to income received wholly from property, for that was not a privilege at all, but an absolute right. The court said in part:

> "The character of the tax is determined by its incidents, not by its name. * * * When a tax is in truth levied for the exercise of a substantive privilege granted or permitted by the state, the tax may be considered an excise tax and sustained as such. * * * But the mere right to hold and own property cannot be made the subject of an excise, because to tax by reason of ownership is to tax the property itself."

In *Thompson v. McLeod*, 112 Miss. 383, 73 So. 193, a tax on turpentine taken by a man from his own trees was held not an excise, but a property tax, because that taking was an absolute right and not a privilege, so that

> "It requires no refinement to observe at once that this is an additional burden of taxation, operating not indirectly, but upon complainant's own property."

This court holds in *Helson v. Kentucky*, 279 U. S. 245, that a state cannot impose an excise tax on what is a matter of absolute right and not a privilege—their doing interstate business.

In *Corn v. Fort*, ... Tenn. ...; 95 S. W. (2) 620, the income tax was claimed to be on the privilege of doing business in partnership. It was held that this was not a taxable privilege but a right, and such excise could not be sustained.

We therefore submit that the Iowa tax cannot be treated

here as an excise so as to avoid our exemption. There is nothing which can be the subject of an excise. The statute itself recognizes that income "from interest, rent, dividends or securities" differs from income from "the transaction of any business carried on for gain or profit" (Sec. 6943-f8 quoted on page 27 above). It does not pretend to impose a privilege tax, a transaction tax, an occupation tax, or any kind of excise. It imposes the tax directly and literally "upon and with respect to the taxable income" (Sec. 6943-f5 quoted above). Appellants exercise no privilege or act separable from their property-ownership, to which this tax can be ascribed as an excise. If it were an excise on the receipt of the income, it would still unconstitutionally impair these contracts, under the rule of *Coolidge v. Long*, 282 U. S. 582, quoted above, so it will not help the state to argue that the tax can be ascribed thereto.

The lower courts say *Brushaber v. Union Pacific Railroad*, 240 U. S. 1, says an income tax is an excise. That statement is made relative to income *not flowing from property alone*. The opinion on page 16 reaffirms the *Pollock Case* in holding that taxing our income is not an excise,

> "since to burden the income by a tax was to burden the property from which the income was derived, and thus to accomplish the very thing which the provision was designed to prevent."

Our exemption statute, if enacted in good faith, surely agreed that the bonds would not be burdened by taxation; and under this language a tax on their income does burden them, and invades their immunity.

It thus appears that this tax has not the essential features or result of an excise which can be imposed without so burdening tax exempt property as to violate the exemption. Regardless of whether it is in the nature of an excise in some other sense, or as to some other incomes, it cannot be imposed here.

The Exemption Is Not Avoided By Calling The Tax One On The Recipient Of The Income Rather Than On The Income As Such.

The opinions below also suggest that an income tax is justified as a tax on the recipient of the income rather than on the income as a thing (R. 24).

What has heretofore been said disposes of this makeweight. To tax a person by reason of his ownership of property is to tax the property. To tax the income received solely from ownership of property is also to tax the property. Therefore, to tax a person because he is the recipient of income inuring to him "solely because of the ownership" of bonds is, by the same token, to tax the bonds.

Furthermore the Income Tax Statute above quoted, imposes the tax "on and with respect to taxable income" and thus *is* on the income as well as on the recipient.

The cases speaking of income tax as a tax on the recipient of income neither consider nor involve the distinction between our sort of income and incomes generally. They do not involve or consider questions of contractual exemption, or the rights growing therefrom. They do not bear, even remotely, on the contract clause of the constitution, nor rule our case which depends wholly upon the guarantees of that clause.

The Doctrine of MacAllen v. Massachusetts And Gillespie v. Oklahoma Has Not Been Overruled Or Made Inapplicable.

The foregoing discussion makes it easy to show the fallacy of the view (R. 26) that this court has overruled *MacAllen v. Massachusetts* or made it inapplicable. The cases said to have that effect are *Pacific Co. v. Johnson*, 285 U. S. 480, and *Educational Films Co. v. Ward*, 282 U. S. 379.

The lower courts refer to the dissents in *MacAllen v. Massachusetts*. In that case, however, all the judges there

agreed that if the state laid a net income tax to include interest from tax-free bonds, it was *pro tanto* void. The minority disagreed because they thought the Massachusetts statute did *not* impose an *income tax* at all, but only a tax on the privilege of exercising a corporate franchise. The Massachusetts statute applied only to corporations, and so might be thought to impose a franchise tax and not an income tax. The unanimous holding in *MacAllen v. Massachusetts* is that, once we find the tax *is a net income tax*, and not a corporate franchise tax, it cannot include interest from contractually exempt bonds. Admittedly, the Iowa Tax is an income tax and not a franchise tax. It is labeled an income tax. It is levied specifically on and with respect to incomes. It explicitly excludes corporations; and so cannot be a tax on their franchise.

Pacific Co. v. Johnson, 285 U. S. 480, and *Educational Films Co. v. Johnson*, 282 U. S. 379, involve franchise taxes on corporations. They also agreed that *if* the taxes there involved were *income taxes*, and not franchise taxes, they could not include income from tax free bonds. They do not overrule the *MacAllen* Case on any point; and on the point now before the court they approve it. So *Pacific Co. v. Johnson*, 285 U. S. 480,

> "* * * the question still remains whether the immunity is broad enough to secure freedom from taxation of a corporate franchise tax to the extent it is measured by tax exempt income.
>
> "The rule that a tax upon a franchise * * * is not an infringement of that immunity was re-examined and affirmed in *Flint v. Stone Tracy Co.*, 220 U. S. 107, which was accepted as authority in *MacAllen v. Massachusetts*, 279 U. S. 620, and followed in *Corp v. Ward*, 282 U. S. 379.
>
> "This distinction, often and consistently affirmed, is but recognition that the franchise, the privilege of doing business in the corporate form, is a legitimate subject of taxation and does not cease to be such subject because it is exercised in the acquisition and enjoyment

> of nontaxables. The distinction is one of substance and not of form, and has been so recently discussed in *Ed. Films Co. v. Ward* that it need not be elaborated here. It suffices to say that the tax immunity extended to property, qua property, does not embrace a special privilege, the corporation franchise, otherwise taxable. * * * The owner may enjoy his exempt property free of tax, but if he asks and receives the benefit of a taxable privilege as the implement of that enjoyment, he must bear the burden the state exacts as its price."

This means that the tax to be sustained must be a franchise privilege tax, and not a mere income tax. It recognized the owner may enjoy his exempt property (and that means its income) free of the tax, unless he asks and receives from the state some additional privilege for which it can exact a tax. It necessarily implied that an income tax cannot be imposed on and with respect to this interest; for otherwise there would have been no need to point out so carefully that the tax there was not an income tax but a franchise tax. The majority in the *Johnson Case* did not challenge the statement in the dissent that:

> "It is not denied, as we understand, that if the state had laid the tax directly on the income derived from the bonds, an unconstitutional impairment of the obligation would have resulted."

The question was whether that tax, distinctly laid on a separate taxable privilege, might value the privilege according to income. The majority, holding it might, recognizes a distinction "*of substance*" between so doing and taxing income. We have no question of valuing a privilege by exempt income, for our tax is laid on no privilege, and there is no privilege to value. We have owners of exempt property seeking simply to enjoy that property free of taxation on the interest accuring to them solely from their ownership; and the Johnson case recognized that must be conceded.

Educational Films Co. v. Ward, 282 U. S. 379, was exactly like the *Johnson* Case. It recognizes explicitly the rule for which we contend, saying that if the tax

> "is in reality a tax on income it as such falls within the class of taxes which concededly may not be imposed"

and points out that the franchise tax is levied wholly for the privilege of doing business; is not a tax on the income of the corporation in a given year, but on the privilege of doing business this year measured by last year's income; that it cannot exist independent of the enjoyment of the corporate franchise, and can be levied only when the corporation both seeks and exercises that privilege. It says that there is a distinction between a tax "invalid because laid directly upon * * * income derived from" securities, and a franchise tax. It does not say the *MacAllen* case is overruled, but holds that the statute involved in the *MacAllen* case was not a franchise tax but an ordinary income tax and thus is

> "brought within the purview of *Miller v. Milwaukee*, 272 U. S. 713, with respect to a state tax on income, no franchise or privilege tax being involved."

These cases, far from overruling *MacAllen v. Massachusetts*, reaffirm it.

The article in 30 Columbia Law Review, 92 at 100, is cited below as criticizing the *MacAllen* case (R. 26). But it finds no fault with the rule that a tax on income from exempt bonds violates the exemption; but only questions the holding that the Massachusetts tax *was* an income tax rather than a franchise tax. With that we are not concerned.

The idea (R. 26) that *Burnet v. Coronado Oil Co.*, 285 U. S. 393, made *Gillespie v. Oklahoma*, 257 U. S. 501, inapplicable here is refuted by the following quotation from *Burnet v. Coronado* itself:

> "We are disposed to apply the doctrine of *Gillespie v. Oklahoma* strictly, and only in circumstances closely analogous to those it disclosed. In principle, however, the present claim of exemption cannot be distinguished from the one presented in the earlier case, and we adhere to the rule there approved. * * * The opinion in *Gillespie v. Oklahoma* has often been referred to as the statement of an accepted principle."

That accepted principle is that an income tax on the income from tax-exempt property violates the exemption of that property from taxation. That principle rules this case; and the citations and suggestions of the lower courts show nothing that properly escapes it.

People v. Gilchrist, 262 U. S. 94, Does Not Permit This Tax.

The only authority cited by the lower courts which is not fully met by the previous discussion is *People v. Gilchrist*, 262 U. S. 94, (R. 23). That decision is that, since the state courts rendered no opinions, this court could not be sure what their ruling was and was unable to perceive error. The judgment was merely affirmed, not as sound, but as having some plausible foundation. Such affirmance is of little value as a precedent. The situation seems to have been this: a statute provided that on payment to the local recorder of a fee for recording a mortgage, or paying a millage tax to the state comptroller instead of the local collector, the mortgage debt should be exempt from further taxation. A later income tax law included interest on mortgages. This court said in substance: (a) that the state statute might have meant the mortgage should be only exempt from taxation by the local authorities, but not by the state; or (b) that the exemption might have been only for the year during which the recording fee or millage tax was paid, since the payment of those taxes as an alternative for others would be consideration only for the period they paid for; or (c) that, since the state got no benefit from the exemp-

tion, it was not presumed to have abrogated its power to levy new forms or tax by merely imposing a recording fee, for the state did not need to offer any such bargain to induce people to record mortgages. None of these considerations apply here. Iowa did get a benefit from this bargain, which enabled it to sell its bonds at a high price for a low yield. The term our exemption paid for has not expired; it runs so long as the bonds issued under it remain outstanding. It is broader than an exemption for merely one year.

People v. Gilchrist, therefore involves a situation different from ours in the nature, scope and purpose of the exemption; and the foregoing considerations, which induced it, do not rule us. Why take the earlier case of *People v. Gilchrist*, confused by many considerations not here applicable, to the exclusion of the later cases of *MacAllen v. Massachusetts; Northwestern Mutual Life Insurance Co. v. Wisconsin*, 275 U. S. 136, and *National Life Ins. Co. v. United States*, 277 UP. S. 508, all of which hold explicitly that an income tax on interest from exempt securities is a tax on them to violate the exemption? *People v. Gilchrist* was not supposed to impair or overrule *Gillespie v. Oklahoma*, 257 U. S. 501, which lays down as an accepted principle, later recognized, that income from exempt property is as immune from income taxation as the property is from property taxation. We submit that those cases, and not the Gilchrist case, apply here.

CONCLUSION.

The validity of this tax, and the decision whether it impairs our constitutional rights, does not depend on Iowa's abstract power to tax incomes, nor on the validity of its income tax law as a whole, or as applied to others. Its validity depends on its effect on appellants (*White v. John-*

son, 282 U. S. 267 at 373). A tax which a state may, abstractly or generally, have power to levy is

> "void in particular cases, either as unconstitutional * * * violation of contracts * * * or because in some other way they operate to deprive the complaining party of a right secured him by the Constitution of the United States."—*General Oil Co. v. Clark*, 209 U. S. 211 at 228.

No matter how constitutional the law may be as applied to persons generally, it cannot apply to us to include this interest and to that extent is *pro tanto* void.

Respectfully Submitted,

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1936

No. [redacted] 16

HENRY O. HALE AND ELIZABETH C. HALE,
Appellants,

vs.

THE IOWA STATE BOARD OF ASSESSMENT AND REVIEW.

APPEAL FROM THE SUPREME COURT OF THE STATE OF IOWA.

STATEMENT OPPOSING JURISDICTION.

JOHN H. MITCHELL,
Attorney General of Iowa;
CLAIR E. HAMILTON,
Assistant Attorney General of Iowa;
LEON W. POWERS,
Counsel for Appellee.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1936.

No. 832

HENRY O. HALE AND ELIZABETH C. HALE,
Appellants;

vs.

THE IOWA STATE BOARD OF ASSESSMENT AND REVIEW.
Appellee.

STATEMENT AGAINST JURISDICTION OF THE SUPREME COURT OF THE UNITED STATES.

MAY IT PLEASE THE COURT:

The appellee, the Iowa State Board of Assessment and Review, now makes and files the following statement against the jurisdiction of the Supreme Court of the United States:

(A) SECTION 6944 OF THE IOWA CODE OF 1935 HAS BEEN CONSTRUED BY THE SUPREME COURT OF IOWA.

The Supreme Court of Iowa has always construed Section 6944 of the Code of 1935 to contain an exemption only from a general property tax.

Sioux City v. *School District* (1880), 55 Iowa 150, 7 N. W. 488;

Edwards & Walsh Construction Company v. *Jasper County* (1902), 117 Iowa 305, 90 N. W. 1006;

Iowa Mutual Tornado Ins. Assn. v. *Gilbertson* (1906), 120 Iowa 658, 106 N. W. 153;

State of Iowa v. *City of Des Moines* (1936), 266 N. W. 41 (not yet in Iowa Reports).

Referring to the above cases appellee calls the Court's attention to the fact that the present Section 6944 of the Iowa Code of 1935 is made of twenty-two subdivisions or paragraphs. This section made up of a portion of the subdivisions has been a part of the law of Iowa since the Code of 1851. That portion of the section exempting municipal, school, drainage or levy districts, and county bonds or certificates from taxation was enacted by Chapter 81 of the session laws of 1909. Prior to the enactment of 1909, the Supreme Court of Iowa had already construed the statute as containing an exemption only from a general property tax. The Iowa Legislature, when it amended the statute by granting an exemption to the classes of bonds involved in this action, knew that the statute which it was amending applied only to an exemption from a general property tax.

(B) THE CONSTRUCTION PLACED ON SECTION 6944 (5) BY THE SUPREME COURT OF IOWA IS CONCLUSIVE ON THE UNITED STATES SUPREME COURT.

The Iowa Court held that such statute contained an exemption only from a general property tax. The United States Supreme Court is bound by the Iowa decisions.

Atlantic Coast Line R. Co. v. *Goldsboro*, 232 U. S. 548, 58 L. Ed. 721, 34 Sup. Ct. Rep. 364.

(C) THE SUPREME COURT OF IOWA HAS CONSTRUED SECTIONS 6943-F-4 TO 6943-F-27 (PERSONAL NET INCOME TAX LAW) AS IMPOSING AN EXCISE TAX RATHER THAN A PROPERTY TAX.

Henry O. Hale and Elizabeth C. Hale v. *Iowa State Board of Assessment and Review.* (Decided January 19, 1937; not yet reported either in Iowa Reports or Northwestern Reports; copy attached to Appellants Statement as to Jurisdiction.)

(D) THE SUPREME COURT OF THE UNITED STATES WILL ACCEPT THE CONCLUSION OF THE IOWA SUPREME COURT THAT THE IOWA PERSONAL NET INCOME TAX LAW (SECTIONS 6943-F-4 TO 6943-F-27) IMPOSES AN EXCISE TAX RATHER THAN A PROPERTY TAX.

New York ex rel. Clyde v. *Gilchrist*, 262 U. S. 84, 43 Sup. Ct. Rep. 501, 67 L. Ed. 883;
New York ex rel. Troy Union R. Co., 254 U. S. 47, 41 Sup. Ct. Rep. 17, 65 L. Ed. 123.

(E) This case is governed by the decision of the United States Supreme Court in *New York ex rel. Clyde* v. *Gilchrist*, 262 U. S. 84, 43 Sup. Ct. Rep. 501, 67 L. Ed. 883.

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FILE COPY

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Appellee.

APPEAL FROM THE SUPREME COURT OF THE STATE OF IOWA.

APPELLEE'S BRIEF AND ARGUMENT.

JOHN H. MITCHELL,
Attorney General,
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APPELLEE'S BRIEF AND ARGUMENT.

THE OPINION BELOW.

The opinion below is not yet officially reported. It appears on page 7 of this Record and in 271 Northwestern Reporter 168.

STATEMENT OF THE CASE.

Sec. 1304 of the Code of Iowa 1907 provides:

"Sec. 1304. *Exemptions.* The following classes of property are not to be taxed:"

(Then follows seven paragraphs listing the exemptions.)

In 1909 the legislature by Chapter 81 of Session Laws of 1909 amended the statute by adding to ths list of exemptions, the following:

> "Municipal, school and drainage bonds or certificates hereafter issued."

This clause was later amended by adding thereto the phrase,

> "by any municipality, school district, drainage district or county within the State of Iowa." (R. 6.)

All of the municipal and school bonds owned by appellant were issued after the amendment of 1909.

The road bonds involved were issued under, and after the passage of, the Iowa Statute now known as Section 4753-a13 of the Code of 1935, which provides:

> "Bonds and Road Certificates (whether issued in anticipation of special assessments or in anticipation of annual allotments of the primary road fund) shall not be taxed." (R. 6.)

The $1,000.00 "Soldier's Bonus Bond" was issued by the State of Iowa pursuant to Chapter 332 of the acts of the 39th General Assembly, Sub-section 10, of which provides:

> "Exemptions. All payments and allowances made under this act shall be exempt from taxation * * * and all bonds issued hereunder shall be exempt from taxation." (R. 6 and 7.)

Chapter 329-F1 of the Code of 1935, (Personal Net Income Tax) in so far as it applies to this case, provides as follows:

> "6943-f5. Tax imposed. A tax is hereby imposed, beginning the first day of January, 1934, upon every resident of the state, which tax shall be levied, collected

and paid annually upon and with respect to his entire taxable income as herein defined at rates as follows:

6943-f7. 'Net income' defined. The term 'net income' means the gross income of the taxpayer less the deductions allowed by this division.

6943-f8. 'Gross income' defined—exceptions.

1. The term 'gross income' includes gains, profits and incomes derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, business, commerce, or re-occurring profits and income growing out of the ownership or use of or interest in property, real or personal; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit; or gains or profits, and income derived from any source whatever and in whatever form paid. The amount of all such items shall be included in the gross income of the tax year in which received by the taxpayer, unless, under the methods of accounting permitted under this division, any such amounts are to be properly accounted for as of a different period.

2. The term 'gross income' does not include the following items, which shall be exempted from taxation under this division:

(d). Interest upon the obligations of the United States or its possessions, agencies, or instrumentalities, which is or shall be exempt from state taxation by federal law.

(e). Salaries, wages, pensions and other compensation received from the United States by officials, employees or veterans thereof which are or shall be exempt from state taxation by federal law."

The appellants were engaged in farming and looking after their investments. (R. 20.)

There is no disagreement as to the amount of the tax, if any, but merely as to the validity.

SUMMARY OF THE ARGUMENT.

1. The statutory exemption from taxation is not contractual, and therefore not protected by the federal constitution.

a. In order that a state may be bound by a statutory exemption from taxation there must be a binding contract supported by consideration.

b. A mere gratuity or bounty does not amount to a contract.

c. A general statutory exemption from taxation is construed to be a gratuity, and not a contract.

d. There was no consideration for the exemptions of the bonds held by plaintiff, hence there was no contract.

2. There is no presumption that state, county and municipal bonds are exempt from taxation.

3. The statutes under which the exemptions are claimed by appellants apply only to *general property taxes*, and not to an excise tax.

a. The exemption statute had been construed by the Supreme Court of Iowa to apply only to general property taxes, prior to the time it was amended to include municipal, county, state and school bonds.

b. Therefore, the legislature knew that it was amending a statute which exempted only from general property taxes.

4. A general income tax, such as contained in Chap. 329-F1 of Code of 1935 is not a property tax but an excise tax.

a. Income is not property.

b. The Iowa Supreme Court has so held.

5. *People* v. *Gilchrist*, 262 U. S. 84; 64 L. ed. 883, is authority for the proposition that the Iowa income tax statute does not violate the contract clause of the federal constitution.

6. Cases on which appellants rely, as holding that to tax the interest is to tax the bonds, are not authority for the questions involved in this case.

a. Most of those cases deal with the power of the state to tax the federal government or its instrumentalities.

b. Not one of them deals with the right of a state to tax its own citizens, under a general income tax statute.

7. *Macallen* v. *Massachusetts*, 279 U. S. 620, is not applicable.

a. The exemption statute there involved exempted persons as well as property.

b. The taxing statute, by amendment was aimed directly at interest from the tax-exempt bonds.

c. The Massachusetts taxing statute construed in the *Macallen* case did not impose a general income tax, but applied only to domestic business corporations.

8. The Iowa income tax is not aimed at interest from tax free bonds. It is a tax on the recipient of the income measured by his income from all sources.

ARGUMENT.

The Exemption Was Not Contractual.

Appellants argue that the exemptions contained in Section 1304 of the Code of 1897, continuing through the Code of 1907 as amended, and now appearing as Section 6944 (5) of the Code of 1935, pertaining to municipal, school, drainage, county and state bonds, as well as Section 6944 (22) and Section 4753-a13, are contractual. They insist that when the bonds were issued the statutes then in force with reference to exemptions became a part of a statutory contract under which the bonds were issued and purchased. We do not believe it is necessary for this Court to determine whether or not the exemption is contractual, as will be shown later in this argument. We say, however, that we cannot agree with statement of appellants' counsel.

In their argument counsel for appellants cite and rely upon the decision in *Pacific Railroad Company* v. *McQuire*, 20 Wall, 36; 22 L. Ed. 282. It should be noted that that case did not involve the repeal of a prior general statute exempting the property from taxation; but rather involved an exemption from taxation contained in the charter of the company. The exemption was granted by the Act of the legislature organizing the company and under which the charter was issued. Under the decisions of the Supreme Court of the United States, as well as the Courts of the different states of the Union, a distinction has been recognized between an exemption from taxation which is in the nature of a gratuity provided by statute, and an exemption based on a valid consideration, and contained in the charter of a corporation. The Courts have generally held that where the legislature in granting the charter to a corporation, for the purpose of

inducing it to enter business in the state or to build a railroad, exempts such property from taxation for a certain period of time, the provisions of the charter are in the nature of a contract, and a subsequent statute taxing that property violates the obligation of the contract. On the other hand the Courts have held, and almost unanimously, that a statute which grants a gratuity or bounty in the nature of an exemption, for the purpose of inducing corporations to enter into a certain business, does not constitute a contract between the state and the property owner. That such a statute exempting property from taxation may be repealed at the will of the legislature is generally agreed.

In *East Saginaw Salt Mfg. Co.* v. *City of East Saginaw*, 13 Wall. 373; 20 L. Ed. 611, there was involved the constitutionality of a statute of the State of Michigan repealing a former act of the legislature of that state which provided in substance that all companies or corporations formed or that may be formed for the purpose of boring for and manufacturing salt should be entitled to have all their property, real and personal, used for the purposes mentioned in the act, exempt from taxation for any purpose. The act also provided for the payment of a bounty of ten cents for each and every bushel of salt manufactured by any individual, company or corporation, from water obtained from boring in the State of Michigan. It was argued on behalf of the salt company that the prior act held out an inducement or offer to induce parties to embark in the business of manufacturing salt in Michigan, and when such parties did subsequently engage in that business, and actually produce and manufacture salt, the act became a contract between the state and such parties, which a subsequent legislature could not constitutionally revoke or repeal.

The Supreme Court of the United States, after stating that it was within the power of the legislature to make a

valid contract exempting certain property from taxation, held that no such contract was created by the prior statute granting the exemption under consideration in that case. The Court said there was no consideration for the contract, and that there was no obligation on any person to comply with the conditions of the law. That it was purely voluntary on the one part and therefore purely voluntary on the other part; that is, on the part of the legislature, to continue, or not to continue the law.

The Court further stated that the case differs entirely from the case of a charter granted to a private corporation. That in the case of a charter granted, powers and privileges are conferred by the state, and corresponding duties and obligations are assumed by the corporation. And that if no right to alter or repeal is reserved, stipulations as to taxation, or as to any other matter within the power of the legislature, are binding on both parties.

The Court then went on to say that the Act of the legislature there under consideration could not be interpreted on that principle. That the Act was in its nature a general law, regulative of the internal economy of the state. That it merely granted a gratuity or bounty, and was therefore repealable at the desire or will of the legislature.

Again in *Grand Lodge of the State of Louisiana* v. *City of New Orleans,* 166 U. S., 143; 41 L. ed., 951, the United States Supreme Court considered the constitutionality of a provision of the Constitution of Louisiana. There a prior act of the legislature had exempted a certain building (naming it in the act) owned by the Grand Lodge from taxation so long as it was occupied by the Grand Lodge. Subsequent to the enactment of that statute a new constitution was adopted by the state containing a provision exempting from taxation property of charitable institutions, provided the

property so exempted was not used or leased for purposes of private or corporate profit or income. The Supreme Court of the United States held that there was no consideration for the original enactment of the legislature exempting the entire building from taxation. That it was a mere offer of bounty or a gratuity, and notwithstanding the recipients of such gratuity or bounty may have incurred expense upon the faith of the offer, the state is not bound thereby, and a subsequent legislature might constitutionally repeal such exemption.

Again in *Wisconsin and Michigan Railway Co.* v. *Powers*, 191 U. S., 379; 48 L. ed., 229, there was involved the constitutionality of an act of the State of Michigan repealing an exemption from taxation granted to the railway company by a prior act of that state, on the ground that it impaired the obligation of a statutory contract. The alleged contract levied a tax upon railroads, but provided "that the rate of taxation fixed by this Act or any other law of this state shall not apply to any railway company hereafter building and operating a line of railroad within this state north of parallel 44 of latitude, until the same has been operated for the full period of ten years, unless the gross earnings shall equal $4,000.00 per mile," etc. The railroad company later built a road north of the line designated by the statute, and its gross earnings had never equaled $4,000.00 per mile, so that it would be entitled to the exemption if the earlier statute had not been repealed. The contention of the company was that a later act of the legislature, repealing the exemption above quoted, impaired the obligation of a statutory contract, and thus violated Article I, Section 10, of the Constitution of the United States.

The United States Supreme Court again held the repealing statute to be valid. In passing upon the question, the Court made this pronouncement:

"In the case at bar, of course the building and operating of the railroad was a sufficient detriment or change of position to constitute a consideration if the other elements were present. But the other elements are that the promise and the detriment are the conventional inducements each for the other. No matter what the actual motive may have been, by the express or implied terms of the supposed contract, the promise and the consideration must purport to be the motive each for the other, in whole or at least in part. It is not enough that the promise induces the detriment or that the detriment induces the promise, if the other half is wanting. If we are to deal with this proviso in a general tax law as we should deal with an alleged simple contract, while, no doubt, in some cases between private persons the above distinctions have not been kept very sharply in mind (*Martin* v. *Meles*, 179 Mass., 114, 117; 60 N. E., 397), it is clear that we should require an adequate expression of an actual intent on the part of the state to set change of position against promise before we hold that it has parted with a great attribute of sovereignty beyond the right of change."

And in *Shiner* v. *Jacobs*, 62 Iowa, 392; 17 N. W., 613, the Court was called upon to consider the constitutionality of an Act of the legislature of this statute which reduced or altered the exemption from taxation of forest trees or timber exempted under a prior statute. The plaintiff contended that after the passage of the prior act, he had planted some forty-seven acres of forest trees, complying with the provisions of the act as to the manner of planting and the manner of cultivating. The later act, he contended, was unconstitutional because it altered the amount or extent of the exemption granted by the prior act which was held out to him as an inducement to plant forest trees. The Supreme Court of Iowa said the exemption provided was an act of general legislation, and applicable to all prairie land in the state. That every owner of land was thereby invited to devote a part of his land to the culture of forest trees. That

the law was not in the nature of a contract between the state and such land owners as availed themselves of its provisions, but more in the nature of a inducement or a gratuity. The Court said it had long been well settled that where an exemption from taxation is provided by the general laws of the state, any subsequent legislature may alter or remove the exemption. The Court also cited and quoted from as authority, the case of *Salt Company* v. *East Saginaw, supra.*

In *Miller* v. *Hagemann,* 114 Iowa, 195; 86 N. W., 281, an Act of the legislature provided that in all cities existing under special charter, having a population of more than 10,000, whenever any real estate may by ordinance be assessed with any special tax for the improvements of streets, then such real estate, so specially assessed, and the special assessment upon which shall be paid, shall after such payment be exempted from taxation for general road or street tax which might thereafter be assessed against it. The City of Davenport enacted an ordinance providing for an exemption authorized by the state statute. Later the legislature repealed its act authorizing the exemption. The plaintiff then commenced an action in mandamus to compel the defendant, Treasurer of the City of Davenport, to give him credit for, and mark as discharged, a charge for district road taxes in that city. Plaintiff contended that the repealing statute was unconstitutional because it impaired the obligation of a contract created by the prior Act of the legislature, and the City Ordinance passed pursuant thereto.

The Supreme Court of Iowa in holding that there was no impairment of the obligation of a contract by the enactment of the repealing statute, said:

> "The power of taxation is one of the sovereign and necessary powers of government, and, although it has finally been settled, after much contention, that this power may be limited by the granting of exemptions

which will, under the provisions of the federal constitution prohibiting the impairment of contracts, be irrepealable if provided for in a valid contract made by the state,—as, for instance, where they are given as an incident to a grant of land upon a consideration, or are embodied in a charter contract—yet the presumption is against any such surrender of the power of the state, and the exemption will be deemed repealable unless it clearly appears not only that the exemption is one which might be granted under the power of the state to contract, but also that it was clearly intended to be made irrepealable. This position is tersely stated in *Bank* v. *Billings*, 4 Pet., 514, 561; 7 L. Ed., 939, 955, as follows: 'That the taxing power is of vital importance, that it is essential to the existence of government, are truths which it cannot be necessary to affirm. It would seem that the relinquishment of such a power is never to be assumed. We will not say that a state may not relinquish it; that a consideration sufficiently valuable to induce a partial release of it may not exist; but, as the whole community has a right to insist that its abandonment ought not to be presumed in a case in which the deliberate purpose of the state to abandon it does not appear'."

Further in the opinion the Court, in citing many authorities including *East Saginaw Salt Co.* v. *City of East Saginaw*, *supra*, and *Grand Lodge of Louisiana* v. *New Orleans*, *supra*, said:

> "It is well settled that a general exemption from taxation, not embodied in a contract, is repealable, *even though property has been acquired or expenses incurred in reliance thereon.* Such an exemption is in the nature of a bounty, and not a contract, and 'those who rely upon it must base their reliance upon the free and voluntary good faith of the legislature'."

What is the nature of the exemption granted by Section 6944 (5) and (22), and Section 4753-a13 of the Code of 1935? There was no consideration for the enactments of the exemptions therein contained. Those exemptions were

granted by the legislature as a mere gratuity or bounty. True it is that the appellants have invested their money in county, municipal, school, primary road and bonus bonds. Nevertheless, every one of these bonds, as shown by the record in this case, were selling at par or above at the time the case was tried in the lower Court. The appellants were not induced to invest their money in any particular business by any promise of the legislature that such statute would never be repealed. Nor was there anything contained in any of the statutes herein involved which could be construed as binding upon the State of Iowa.

This Court has often said that the power of taxation is one of the sovereign and necessary powers of government, and is inherent in the state. That its abandonment will never be presumed, in view of its vital importance and its necessity to the existence of government. There is nothing contained in the statutes here under consideration upon which this Court could say that the legislature intended to exempt such bonds from taxation for all time to come. Nor is there anything in the act upon which this Court could base a construction that the legislature intended to say to investors "If you will invest your money in the types of bonds stated in these statutes, the State of Iowa promises and agrees not to tax them." There is nothing in the act upon which such a promise or agreement could even be inferred or presumed to have been made by the legislature. All the legislature did was to grant an exemption to those types of bonds without any statement or explanation as to how the exemption was being granted. As stated in *Wisconsin and Michigan Railway Co.* v. *Powers, supra*, the legislature was not making a promise, but framing a scheme of public revenue. It announced its policy, and possibly opened a chance for benefits to those who purchased the types of bonds indicated in the various statutes, *but it did not address them, and therefore it made no promise to them.*

There Is no Presumption That State, County and Municipal Bonds Are Exempt From Taxation.

It is a well known rule followed generally by the Courts that the power to tax is not granted to the states by constitutional provision, but is inherent in the state, and that unless the constitution contains a limitation on the right of the legislature, its power to tax is not limited. This rule extends to the taxation of municipal bonds generally. The following authorities uphold the doctrine:

26 Ruling Case Law 334, Section 292.
State v. *Page*, 100 W. Va., 166; 130 S. E., 426; 40 A. L. R., 501.
State National Bank v. *City of Memphis*, 116 Tenn., 641; 94 S. W., 606; 7 L. R. A. (ns), 663.
Com. v. *Maury*, 82 Va., 883; 1 S. E., 185.
Stoddard v. *Corbin*, 94 Conn., 543; 109 Atl., 813.
Easton v. *Board of Review*, 183 Ill., 255; 55 N. E., 716.
Hall v. *Middlesex County Commissioners*, 10 Allen (Mass.), 100.
State v. *Woodrull*, 37 N. J. Law, 139.
British Commerce Life Ins. Co. v. *Commissioners of Taxes and Assessments*, 31 N. Y., 32.
People ex rel Niagara Fire Ins. Co. v. *Board of Commissioners of Taxes and Assessments*, 76 N. Y., 64.
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Com. v. *City of Philadelphia*, 27 Pa., 497.
Wilkes-Barre Deposit & Savings Bank v. *City of Wilkes-Barre*, 148 Pa., 601; 24 Atl., 111.

It is not necessary to quote from or state the facts in the cases just cited. The principle is fundamental.

The Statutes Under Which the Exemptions Are Claimed by Appellants Apply Only to General Property Tax.

It should be noted that Section 6944 of the Code of 1935 is made up of twenty-two subdivisions or paragraphs. Some

of these subdivisions have been part of the law of this State since the Code of 1851. That portion of the section exempting municipal, school, drainage or levee districts and county bonds or certificates from taxation was enacted by House File 448 of the 33rd General Assembly, otherwise known as Chapter 81 of the Session Laws of 1909 and was approved on April 16, 1909, and became a part of the law of this State on July 4th of that year.

Subdivision 22 exempting soldiers bonus bonds issued pursuant to Chapter 332 of the Acts of the 39th General Assembly was enacted by that General Assembly. Prior to the adoption of either of these amendments, that is, the one exempting bonds of counties, municipalities and school districts, and the one exempting soldiers bonus bonds from taxation, the Supreme Court of Iowa had on several occasions held that Section 797 of the Code of 1873, which section has been carried forward as Section 1304 of the Code of 1897, and 1907, and now appears as Section 6944 of the Code of 1935, had reference only to general property taxes.

In the case of *Sioux City* v. *School District*, (1880) 55 Iowa, 150; 7 N. W., 488, it was held that the exemption contained in Section 797 of the Code of 1873 *applied to general property taxes* and not to a special tax such as an assessment for street improvements.

In the case of *Edwards & Walsh Construction Company* v. *Jasper County*, (1902) 117 Iowa, 305; 90 N. W., 1006, it was held that the provision of the statute which exempted the property of a county devoted entirely to public use did not apply to special assessment for street improvements, *but only to a general property tax.*

Again in *Iowa Mutual Tornado Ins. Assn.* v. *Gilbertson, State Treasurer, et al.*, (and seventeen other cases) (1906), 129 Iowa, 658; 106 N. W., 153, the Supreme Court of Iowa

said that the exemption from taxes of the property of religious, charitable and educational institutions granted under Section 1304 of the Code of 1897 (being the same as Section 6944 of the Code of 1935) did not grant an exemption from a business or license tax, *but only general property taxes.*

The above cited cases are only a few of those in which the Supreme Court of Iowa has said that what is now Section 6944 of the Code of 1935, applies only to property taxes.

After the decisions in the three cases just cited the legislature of Iowa amended Section 1304 of the Code of 1897 by inserting what is now subdivision (5) of Section 6944 of the Code of 1935, thereby granting an exemption to the bonds or certificates issued by municipalities, drainage districts, school districts and counties. Then at a later date the 39th General Assembly by Chapter 332, Section 10, by its Acts exempted Soldiers bonus bonds. Both of these General Assemblies when they exempted the bonds now mentioned in subsections 5 and 22 of Section 6944 of the Code of 1935, knew that the statute which they were amending had reference only to exemptions from property taxes, and did not include an exemption from any other class of taxes. It had been held prior to these amendments that the statute did not apply to special assessments or to privilege or license taxes, and in each decision it was clearly stated that the statute applied *only to general property taxes.* In view of the fact that the two General Assemblies, the 33rd and the 39th, knew that the statute applied only to general property taxes, it is conclusive that their intention was to exempt the bonds under consideration from general property taxes *and from no other tax.*

In *State of Iowa* v. *City of Des Moines, et al.,* (March 17, 1936) 266 N. W., 41 (not yet reported in Iowa reports), the Supreme Court of Iowa made the very latest pronouncement concerning Section 6944 of the Code of 1935, in which the

Court followed its prior holdings and said that Section 6944 has no application to an excise tax but only to a property tax.

The Iowa Supreme Court is not the only one that has passed on this question. Numerous other states have been called upon to determine whether or not a general constitutional or statutory provision exempting property of a state, county or municipal corporation, including bonds, from taxation, applies only to general property taxes, or whether it also applies to an excise tax. Quite generally the Courts have held that such a constitutional or statutory exemption applies only to general property taxes. Some of the cases which may be relied upon in support of the proposition are:

City of Portland v. *Kozer*, 108 Ore. 375; 217 Pac. 833.

Crockett v. *Salt Lake County*, 72 Utah 337; 270 Pac. 142.

Independent School District v. *Pfost*, 51 Idaho 240; 4 Pac. (2d) 893; 84 A. L. R. 820.

City of Ardmore v. *State of Oklahoma*, 32 Pac. (2d) 728.

Oregon v. *Preston*, 103 Ore. 631; 206 Pac. 304.

State v. *City of Sioux Falls*, 60 S. Dak. 330; 244 N. W. 365.

State v. *Board of Commissioners of Barton County, Kansas*, (1935) 51 Pac. (2d) 33.

The last group of cases cited deal more with exempting property of a county or state rather than bonds. However, it seems to us that the same rule applies.

In *Van Dyke* v. *Wisconsin Tax Commission*, (March 5, 1935) 217 Wis., 528; 259 N. W. 700, the Supreme Court of Wisconsin had before it practically the same question with which this Court is confronted. The question was whether or not interest from county road bonds was subject to an income tax. The statute under which the bonds were issued

became a law of Wisconsin on June 15, 1911. Section 1317M-12 provided as follows:

> "Any county, if its board shall so determine, may raise money for original improvement of any portion of the system of prospective highways *by issuing non-taxable*, four per cent, semi-annual interest payment bonds, running not more than ten years, and not exceeding with all other county indebtedness, the constitutional limit, the money to be expended in the respective towns in portions determined by the County Board according to Section 1317M-5; such bonds to be in such form as the State Highway Commission shall approve, and not to be sold at less than par * * *."

In 1919 sweeping changes were made in the highway laws and the section just quoted was repealed along with other laws, but was immediately re-enacted in Chapter 337 of the Acts of 1919. After the enactment of the Chapter 337 of the laws of 1911, the legislature enacted Chapter 516 exempting from taxation bonds issued by any county, town, city, village, school district, etc., in that state. Shortly after the enactment the legislature enacted Chapter 658 of the laws of 1911 providing for an income tax. The question then was whether or not the exemptions granted by Chapters 337 and 516 of the laws of 1911 was an exemption from property tax or from all taxes.

In passing on the question the Court made this statement:

> "It seems clear to us that at the time Chapter 337, Laws of 1911, was enacted, the only taxation to which such bonds could have been subjected was personal property taxation. Applying the reasoning here that was applied to the first contention relating to municipal bonds, and taking into consideration the fact that all of these acts were considered by the same Legislature, it seems clear that the Legislature, when it authorized the issuing by counties of nontaxable bonds, intended that such

bonds should be free from personal property taxation only. Had the income tax law not been subsequently enacted, no one would contend that Chapter 337 did anything more, or was intended to do anything more, than exempt such bonds from taxation as personal property."

A General Income Tax Law Such as Provided by Chapter 329-F1 of the Code of 1935 Imposes an Excise Tax Rather Than a General Tax on Property.

We do not believe it can be seriously urged by appellants that a general income tax imposes a tax on property. It may be, and we concede that the Courts have held that where a statute imposes a tax on the income from some one particular class of property, such as income from intangibles, it has been held to be a property tax. This view has been adopted not because income is considered as property, but because the statute in question in the particular case was directed at income from a particular class of property, rather than imposing a general income tax.

Generally speaking the Courts, in dealing with a statute which imposes a general income tax, have held that the tax was an excise rather than a property tax. They have also generally said that income is not property, and that the tax is not imposed on the property but on the recipient of the income, upon his right or ability to produce, create, receive and enjoy. The following authorities support this rule:

26 R. C. L. 142, Sec. 117.

Black on income and other federal tax, fourth addition, Sec. 2.

Cooley on taxation, Secs. 1743-51.

Bert Vilas v. *Iowa State Board of Assessment and Review*, (Iowa 1937) 273 N. W. 338.

Hale v. *Iowa State Board of Assessment and Review*, (Iowa 1937) 271 N. W. 168.

City of Dubuque v. *Northwestern Life Insurance Co.*, 29 Iowa 9.

Hattiesburg Grocery Co. v. *Robertson*, 126 Miss. 34; 88 So. 4; 25 A. L. R. 748.

Stanley v. *Gates*, 179 Ark. 886; 19 S. W. (2d) 1000.

Sims v. *Ahrens*, 167 Ark. 557; 271 S. W. 720.

Miles v. *Department of Treasury*, (Ind. 1935) 193 N. E. 855; 97 A. L. R. 1474.

Featherstone v. *Norman*, (Ga. 1930) 153 S. E. 58; 70 A. L. R. 449.

State ex rel Sallie F. Moon Co. v. *Wisconsin Tax Commission*, 166 Wis. 287; 163 N. W. 639.

Maxwell v. *Kent-Coffee Mfg. Co.*, 204 N. C. 365; 168 S. E. 397; 90 A. L. R. 476; affirmed without opinion 78 L. ed. 1040.

Huntoon v. *Commonwealth*, (Va.) 183 S. E. 783.

Cox v. *Sinclair Gulf Oil Co.*, 275 Mo. 339; 265 S. W. 196.

O'Connell v. *State Board of Equalization*, 95 Mont. 91; 25 P. (2d) 114.

In re Opinion of the Justices, 77 N. H. 611; 93 A. 311.

This list of authorities, headed by the three Iowa cases, two of them decided with reference to this specific statute, and the third decided years before an income tax was thought of in any state, all hold that income is not property. The case of *Vilas* v. *Iowa State Board of Assessment and Review*, *supra*, was decided in the spring of 1937. The Iowa Supreme Court in the opinion filed in that case relied on the authority furnished by the other cases cited under this division of the brief. The Court, also, in that opinion relied on the case of *City of Dubuque* v. *Northwestern Insurance Company*, which had been decided years before an income tax law was ever thought of in Iowa, and in which case the Iowa Supreme Court, in the early history of this state, said that income is not property.

If, as heretofore shown, the various Iowa statutes exempting from taxation the types of bonds here involved,

exempt them only from general property taxes, and, if a general income tax, such as we have in Iowa, does not impose a property tax, but an excise tax, then how can it be urged by counsel for appellants that the legislature imposed a tax upon these bonds, which it had agreed would not be imposed. Stating it in another way, if we should concede that the exemption statutes created a contract between the state and the holder of the bonds, that said bonds would not be taxed, we would still be compelled to say that the legislature, by the enactment of the income tax statutes, did not violate the contract, because it did not under the income tax law impose a property tax on the bonds.

People vs. Gilchrist, 262 U. S., 84; 67 L. ed., 883, Is Authority For the Proposition That Such a Statute Does Not Violate the Contract Clause of the Constitution of the United States.

This Court has in reality decided one case which, we believe, sustains appellee's contention. Although the question of interest from tax free state bonds was not involved, yet the legal proposition there raised and decided was analogous. In that case the question was whether or not the interest from certain bonds secured by mortgages was exempt from the income tax of New York State, because of the provision in the recording statute of that state, pursuant to which statute the mortgages were recorded that debts and obligations secured by such mortgages shall be exempt from other taxes by the state and local sub-divisions. This Court, in passing upon the question held that the interest was returnable for state income tax purposes, and that the mortgage recording statute granting the exemption, pertained only to a tax on the bonds, and not to an income tax, saying:

> "A tax upon the individual, measured by net income, might be regarded as one step removed from a tax on the capital from which the income was derived."

Counsel for appellants have attempted to make light of this decision insofar as its applicability to the instant case is concerned. Frankly, is there any difference between the proposition there stated and that for which we contend in the instant case? Does the mere fact that in the *Gilchrist* case bonds secured by mortgages were exempt from taxation make it any different from the instant case, in which the bonds involved are school, municipal and county bonds? Surely such a distinction would be splitting hairs.

We submit that the decision in *People* v. *Gilchrist, supra,* is decisive of the questions raised in this case, and that this Court will have only to rely on that case for its present authority.

Cases on Which Appellants Rely, as Holding That to Tax the Interest Is to Tax the Bonds, Are Not Authority For the Questions Here Involved.

Dawson v. *Kentucky Distilleries and Warehouse Co.,* 255 U. S. 288, involved the validity of a statute of Kentucky which provided for a tax on removal of whiskey to be shipped outside the state, or removed from bond. It was not for the privilege of engaging in business. It was not an income tax. It is inapplicable to the case at bar. There the Court said that it was a tax imposed upon each lot of whiskey at the time it was removed.

Evans v. *Gore,* 253 U. S. 245; 64 L. ed. 887, involved taxing a Federal District Judge on his salary under the federal income tax statute. The Constitution provided that Federal Judges salaries "shall not be diminished during their continuance in office". The Court said this was a limitation imposed in public interest and that the same government was diminishing the salary after it had agreed not to. The case is not in point with the proposition involved in the case at bar.

In *Gillespie* v. *Oklahoma*, 257 U. S. 501; 66 L. ed. 338, the state attempted to tax the instrumentality of the Federal Government. Courts have always said one government may not directly or indirectly burden the other. No question concerning the impairment of the obligation of a contract was involved.

Northwestern Mutual Life Ins. Co. v. *Wisconsin*, 275 U. S. 136; 72 L. ed. 202, is cited by appellant as holding that a state income tax on tax-exempt bonds is void as being a tax on the bonds. The tax there questioned was not an income tax but a 3% tax on the *gross receipts* of domestic insurance companies. The statute taxed every dollar of receipts—not merely net income. Compare this case with *Pacific Co.* v. *Johnson*, 285 U. S. 480, and *Educational Films Co.* v. *Ward*, 282 U. S. 379, where *net income* of a corporation was involved. This case also involved state taxing federal bonds. No question concerning contracts was involved. The statement quoted in *Northwestern Mutual Life Ins. Co.* v. *Wisconsin, supra*, that since *Gillespie* v. *Oklahoma*, 257 U. S. 501, the settled rule has been that where the principal is "absolutely immune" the interest is immune, has no application to interest from bonds exempted by the laws of the state where the bonds were issued.

National Life Ins. Co. v. *United States*, 277 U. S. 508; 72 L. ed. 968, is not in point. There the Federal statute imposed an income tax on corporations, but permitted deduction of interest from tax free bonds, both state and federal. It also permitted a deduction of a sum equal to 4% of the reserve diminished by the amount of interest from tax free bonds. The Court said that if the corporation was entitled to the 4% exemption, it was regardless of whether or not it had any interest from tax free bonds. The Court here found fault with the statute because it subjected one to

heavier burdens on his taxable property merely because he owned some tax free bonds. The statutes showed that it was directed squarely at tax free bonds.

Weston v. *Charleston*, 27 U. S., 449, is cited as authority for the proposition that a tax on the income from exempt securities is a tax on the securities. Appellants avoid mentioning that the securities there involved were United States bonds. The tax was levied by the City of Charleston on all United States bonds and other moneys and credits, as a property tax. This was not in any sense an income tax.

Willcuts v. *Bunn*, 282 U. S., 216; 75 L. Ed., 304, has no application. There the Federal statute exempted interest from state and municipal bonds. The question there was whether profits on sale of municipal bonds were taxable. The Court said yes. It might be noted that the statement made by the Court on the question of the reason for the implied constitutional provision, was that the implication was necessary to maintain our dual system of government. The Court said such taxation was a burden upon the borrowing power of the government whose instrumentalities were taxed by the other. But the question of taxing interest from tax-exempt securities was not under consideration.

In *Trotter* v. *Tennessee*, 290 U. S., 354; 78 L. ed., 358, appellant quotes from the opinion that a contractual exemption "must not be read so grudgingly as to thwart the purpose of the lawmakers." The case had better be cited on behalf of appellee. In the first place the case did not involve interest from tax free bonds, nor the contract clause of the Federal Constitution. In the second place, the exemption claimed was not allowed, the Court saying that because the Federal statute exempted compensation, insurance and maintenance and support paid by Federal Government to a veteran, the exemption could not be extended by construction to include real estate

purchased with the money received from the government by the guardian of the veteran.

Farrington v. *Tennessee*, 95 U. S., 679; 24 L. ed., 558, is not in point. The charter was issued to the Union Planters Bank under an act of the legislature which provided that in lieu of all other taxes it should pay an annual tax of one-half of 1% on its capital stock. Later the state and county imposed general taxes against the one hundred fifty shares owned by plaintiff. In that case we find a plain example of a contract created by the legislature in the provision of the charter. The legislature did more than merely grant an exemption. It agreed not to tax otherwise than as provided by the charter.

Coolidge v. *Long*, 282 U. S., 582; 75 L. ed., 562, is not in point. Here was involved the taxation, for inheritance tax purposes in Massachusetts, of property which had been transferred by trust deeds, long before the statute was enacted. The Court said the deeds were contracts fully executed before the law took effect.

Macallen vs. Massachusetts Is Not Applicable to the Facts In the Case at Bar.

Appellants place much reliance on the opinion of this Court expressed in *Macallen* v. *Massachusetts*, 279 U. S., 620; 73 L. ed., 874. There are some very noticeable distinctions between the *Macallen* case and the present case. In the first place, as stated by the trial court, as well as the Iowa Supreme Court (R. 25), the Massachusetts statute creating the exemption involved in the *Macallen* case is headed, "*Persons and Property* exempt from *Taxation*." The statute then reads: "Section 5. The following property and *polls* shall be exempt from taxation." That statute exempted not only property but persons. The Iowa statute exempts only property. And be-

fore it was amended to include bonds it had been construed to exempt only from a property tax.

Again, the Massachusetts taxing statute construed in the *Macallen* case, is not a general income tax statute but applies solely to domestic business corporations.

Furthermore, under the Massachusetts statute, as originally passed, income from tax exempt securities was exempted from the tax. By amendment the legislature removed the exemption. The result of this amendment was to impose a tax on this interest alone. It was aimed directly at the tax free bonds. It was not a case of taxing all income, including that.

If this reasoning is not correct, then how is it possible to reconcile the opinion in the *Macallen* case with that in the case of *New York* v. *Gilchrist, supra.*

It is true that the *Macallen* case is often cited for the proposition that interest from tax free securities cannot be included in the gross income of a corporation under a statute imposing a franchise tax on a corporation, measured by its net income. That this was never the intention of the Court in the *Macallen* case is definitely and convincingly shown by a reading of the opinions in *Pacific Company* v. *Johnson,* 285 U. S., 480, and *Educational Films Corp.* v. *Ward,* 282 U. S., 379. It is therefore definitely certain that what the Court did in the *Macallen* case was to say that because the legislature was attempting under the amended statute to reach one particular class of income, that is interest from tax free securities, and that alone, it was a tax on the income, rather than on the corporation, and hence nullified the statute.

The Iowa Income Tax Statute Is Not Aimed at Interest From Tax Exempt Bonds.

There is nothing in the Iowa statute which would indicate that the legislature was aiming at the interest from tax exempt securities. In fact the statute shows that the legislaure was not attempting to tax, as property, interest from tax exempt bonds. The statute shows plainly that the tax is imposed upon every resident of the state with respect to his entire net or taxable income. The "net income" means the gross income of the taxpayer less the deductions allowed by law. "Gross income" is then defined to include gains, profits and incomes from salaries, wages or compensation for personal service of every kind and in whatever form paid, or from professions, vocations, trades, business, commerce and income growing out of the ownership or interest in real or personal property; also from interest, rents, dividends, securities, or the transaction of any business carried on for gain or profit; and income derived from any source whatever and in whatever form paid. Under the Iowa statute then, the taxpayer is not paying a tax on the interest from his municipal bonds. He is paying a tax which is measured by his income from all sources. If these plaintiffs invested all of their money in tax free securities, they cannot say that because of their particular investments the law is aimed particularly at the interest received by them.

Counsel for appellants insist on saying that their clients receive the income solely because of their ownership of the bonds, and that therefore a tax is imposed on the bonds. If such statement is correct then was not the tax in *Cohn* v. *Graves*, 81 L. ed., 409, a tax on the foreign real estate? Was not the tax involved in *Pacific Co.* v. *Johnson, supra*, a tax on the bonds? Was not the tax in *Educational Films Corporation* v. *Ward, supra*, a tax on the copyrights?

This Court answered the question in each of those three cases in the negative, just as we believe it will say that the tax imposed on appellants in this case, as recipients of income, is not imposed because of their ownership of the bonds, and is not a tax on the bonds. That on the other hand it is a tax imposed on the individual because of his ability to create, receive and enjoy.

In *Cohn* v. *Graves, supra*, this Court, explaining the distinction between an income tax and a property tax, said:

> "The two taxes are measured by different standards, the one by the amount of income received over a period of time, the other by the value of the property at a particular date."

CONCLUSION.

In conclusion we suggest that we know of no better argument than contained in the opinion and decree of the trial court. That ruling was adopted in its completeness by the Supreme Court of Iowa. (R. 20.) It is the third time in the history of the state that its Supreme Court has adopted and set out in its opinion, the ruling of the trial court. The ruling of the trial court shows on its face that it was prepared after much serious thought. We believe this Court will agree with us that the Supreme Court of Iowa did not err in adopting it.

Respectfully submitted,

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SUPREME COURT OF THE UNITED STATES.

No. 16.—October Term, 1937.

Henry O. Hale and Elizabeth C. Hale, Appellants, *vs.* The Iowa State Board of Assessment and Review. } Appeal from the Supreme Court of the State of Iowa.

[November 8, 1937.]

Mr. Justice Cardozo delivered the opinion of the Court.

The question is whether interest upon bonds of the state of Iowa or its political subdivisions may be included in the assessment of a tax on the net income of the owners without detracting from earlier exemptions in respect of taxes upon property and without an unconstitutional impairment of the obligation of contract.

Appellants, residents of Iowa, were the owners in 1934 and afterwards of Iowa School District bonds, Iowa Road bonds, Iowa County bonds, and an Iowa Soldiers' Bonus bond, of the face value, aside from interest, of $752,900. The statutes of the state in force when the bonds were issued and when the appellants acquired ownership provide in varying but equivalent terms that such bonds "are not to be taxed",[1] "shall not be taxed",[2] or "shall be exempt from taxation."[3] Iowa was without an income tax when these exemptions were declared. A "Personal Net Income Tax" upon persons resident within the state was imposed for the first time by a statute enacted in 1934. Code 1935, sec. 6943-f4 *et seq.* In the assessment of that tax for 1935 interest on appellants' bonds in the sum of $36,893.75 was included by the State Board of Assessment

[1] "The following classes of property are not to be taxed: 1. The property of the United States and this state. . . . municipal, school, and drainage bonds or certificates hereafter issued by any municipality, school district, drainage district or county within the state." Iowa Code Supplement of 1915, sec. 1304, subd. 1; Code 1935, sec. 6944, subd. 5.

[2] "Bonds and road certificates . . . shall not be taxed". Acts 38th G. A. c. 237, sec. 28; Code 1935, sec. 4753-a13

[3] "All bonds issued hereunder [the Soldiers' Bonus Act] shall be exempt from taxation". Acts 39th G. A. c. 332, sec. 10; Code 1935, sec. 6944, subd. 22.

and Review against appellants' protest that the law, if so applied, impaired the obligation of contracts of exemption. Constitution of the United States, Article I, Sec. 10. By appropriate proceedings the controversy was brought to the Supreme Court of Iowa, where the assessment was upheld. 271 N. W. 168. The court assumed, without deciding, that the statutes of exemption should be treated as giving rise to contracts, and not merely as declarations of a legislative policy subject to revocation at the legislative pleasure. Proceeding on that assumption, the court interpreted the contracts as limited to taxes laid directly upon property in proportion to its value, and not as touching taxes in the nature of an excise upon the net income of an owner. This conclusion was supported by an analysis of the Iowa statutes and a review of Iowa decisions as well as the decisions of this and other courts. The case is here upon appeal. 28 U. S. C. § 344.

We make the same assumption that was made in the state court as to the existence of a contract, without indicating thereby how we would rule upon the point if a ruling were essential. Cf. *Clyde* v. *Gilchrist*, 262 U. S. 94, 98; *Pacific Co.* v. *Johnson*, 285 U. S. 480, 489; *Wisconsin & Michigan Ry. Co.* v. *Powers*, 191 U. S. 379, 386; *Dodge* v. *Board of Education of Chicago*, 302 U. S. —. Essential it is not for the decision of this case if the contract to be assumed is limited in scope and operation as it was limited below. Whether the limitation should be accepted is thus the pivotal inquiry. The power is ours, when the impairment of an obligation is urged against a law, to determine for ourselves the effect and meaning of the contract as well as its existence. *U. S. Mortgage Co.* v. *Matthews*, 293 U. S. 232, 236; *Funkhouser* v. *Preston Co.*, 290 U. S. 163, 167. Even so, we lean toward agreement with the courts of the state, and accept their judgment as to such matters unless manifestly wrong. *Phelps* v. *Board of Education*, 300 U. S. 319, 322, 323; *Violet Trapping Co.* v. *Grace*, 297 U. S. 119, 120; *Tampa Water Works* v. *Tampa*, 199 U. S. 241, 243, 244; *Dodge* v. *Board of Education of Chicago, supra.* For reasons to be developed, obvious error is not discernible in the ruling of the highest court of Iowa that the statutory exemptions invoked by the appellants were not intended to include taxes upon the net income derived from business or investments. To the contrary the decision has support in the statutory system of taxation viewed in its entirety, in state de-

cisions both in the courts of Iowa and elsewhere before the bonds were bought and afterwards, and even indeed in decisions of this court. Our search is for something more than the meaning of a property tax or an excise in the thought of skilled economists or masters of finance. It is for the meaning that at a particular time and place and in the setting of a particular statute might reasonably have acceptance by men of common understanding.

1. The limitation affixed to the contracts of exemption has support, first of all, in the statutory system of taxation considered as a whole.

Of the total interest ($36,893.75) collected on appellants' bonds, the greater portion ($32,776.25) is protected, if at all, by reason of the exemption given to bonds issued by any school district or county within the state. That exemption may best be studied as it stood in the Supplemental Code of 1915.[4] It was then subdivision 1 of section 1304. There were other subdivisions exempting other items:—the grounds and buildings for public libraries; household furniture up to a prescribed value; the farming utensils of any person who makes his livelihod by farming; and many other kinds of property. The section opens with the statement that "the following classes of property are not to be taxed", and then enumerates the classes. But the scope of the exemption is likely to be exaggerated unless the next preceding section (1303) is read at the same time. "The board of supervisers of each county shall annually, at its September session, levy the following taxes upon the assessed value of the taxable property in the county", a mandate clearly addressed to the levy of *ad valorem* taxes only. The inference is a fair one that section 1304 did not exempt the items there enumerated from taxation of every form and for every purpose. It withdrew them from the operation of the levy commanded by the section next preceding.[5] True, in later compilations of the stat-

[4] Compare Code of 1851, sec. 455; Code of 1873, sec. 797; Code of 1897, sec. 1304.

[5] An earlier form of the same statute, after providing, like the later one, that "the following classes of property are not to be taxed," adds the significant words, "and they may be omitted from the assessments herein required". Code of 1873, sec. 797. The opinion in Sioux City *v.* Independent School District, 55 Ia. 150, 151, 152, refers to these words as emphasizing the conclusion that exemption relates to taxes on the value of the property. The 1851 Code provision is almost identical.

utes, the sections have been rearranged, though with substance unaffected. Cf. Code, 1935, sec. 6953. In the Code of 1935, subdivision 1 of section 1304 is subdivision 5 of section 6944; section 1303 is section 7171. There can be little doubt that the meaning remains what it was before. *United States* v. *Ryder,* 110 U. S. 729, 740; *United States* v. *Sischo,* 262 U. S. 165, 168, 169; *Warner* v. *Goltra,* 293 U. S. 155, 161; *Davis* v. *Davis,* 75 N. Y. 221, 225, 226; *Fifth Avenue Bldg. Co.* v. *Kernochan,* 221 N. Y. 370, 375; *Mitchell* v. *Simpson,* L. R. 25 Q. B. D. 183, 189.

Besides the school and county bonds, appellants were the owners of a Soldiers' Bonus bond in the sum of $1,000, and Road bonds or certificates to the amount of $82,000. The exemption of the Bonus bond was declared by the statute authorizing the issue. 39th G. A., c. 332, sec. 10, adopted March 23, 1921. The exemption is now subdivision 22 of section 6944 of the Code of 1935, and should be given the same meaning as the exemption conferred by the other subdivisions. The Road bonds or certificates have their exemption under a different statute (sec. 4753-a13, Codes of 1931 and 1935), but the bonds are expressly declared to be obligations of the county (sec. 4753-a14), and, as the court below observed, there is no reason to suppose that the exemption given them was broader than that of county obligations generally.

2. The meaning of the Iowa statutes is clarified, if otherwise uncertain, by the opinions of the Iowa court in this and other cases.

The court in its opinion in this case applied the general principle that contracts of tax exemption must receive a strict consruction. The teaching of this court has been always to the same effect. "Grants of immunity from taxation in derogation of a sovereign power of the state, are strictly construed." *Pacific Co.* v. *Johnson,* 285 U. S. 480, 491, citing many cases. Adhering to that principle, the Iowa court held that the tax exemption was limited to taxes upon property, and could not be extended to taxes in the nature of an excise. For this restriction it found support in its own earlier decisions, rendered many years before appellants' bonds were purchased. Thus, *Sioux City* v. *Independent School District,* 55 Ia. 150, decided in 1880, and *E. & W. Construction Co.* v. *Jasper County,* 117 Ia. 365, decided in 1902, held the exemption inapplicable to special assessments, limiting it at the same time "to the taxes contem-

plated in title 6 of the Code."[6] So also *Insurance Ass'n* v. *Gilbertson*, 129 Ia. 658, decided in 1906, interpreting a different subdivision of the exemption statute, but a cognate one, again limited the exemption to taxes upon property, and refused to apply it to an excise or license tax measured by receipts. The ruling was reiterated in *State* v. *City of Des Moines*, 221 Ia. 642, decided in 1936, upon facts not greatly different. Cf. *Plummer* v. *Coler*, 178 U. S. 115. From these precedents the Iowa court advanced to the holding, announced in the case at bar, that a tax upon net income was substantially an excise, and hence did not come within the scope of an exemption confined to taxes upon property. The result was conceived to be latent in the precedents if effect was to be given to their fair implications. "So the state court has told us", construing its own decisions, "and the good faith of its declaration is not successfully impeached." *Stockholders* v. *Sterling*, 300 U. S. 175, 183.

3. The ruling that a tax upon net income is without the scope of the exemption cannot be adjudged unreasonable, for it will be found to be supported by decisions in many other states, and even, indeed, by decisions of this court.

(a) The question as to the nature of such a tax has come up repeatedly under state constitutions requiring taxes upon property to be equal and uniform, or imposing similar restrictions. Many, perhaps most, courts hold that a net income tax is to be classified as an excise.[7] "The tax levied on income is not a property tax, but is a percentage laid on the amount which a man receives, irrespective of whether he spends it, wastes it, or invests it." *Featherstone* v. *Norman*, 170 Ga. 370, 382; *Purnell* v. *Page*, 133 N. C. 125, 129. As early as 1870, the Supreme Court of Iowa had written an opinion which foreshadows the same thought. *Dubuque* v. *Northwestern Life Ins. Co.*, 29 Ia. 9. Cf. *Vilas* v. *Iowa State Board of Assessment and Review*, 273 N. W. 338. True, there are courts in other

[6] The Code in force at that time was the one of 1873.

[7] Sims *v.* Ahrens, 167 Ark. 557; Stanley *v.* Gates, 179 Ark. 886; Waring *v.* Savannah, 60 Ga. 93, 100; Featherstone *v.* Norman, 170 Ga 370, 379; Diefendorf *v.* Gallet, 51 Idaho 619, 627; Miles *v.* Department of Treasury, 199 N. E. 372 (Ind.); Opinion of the Justices, 133 Me. 525, 528; Hattiesburg Grocery Co. *v.* Robertson, 126 Miss. 34, 52; Ludlow-Saylor Wire Co. *v.* Wollbrinck, 275 Mo. 339, 351; Bacon *v.* Ranson, 331 Mo. 985, 990; O'Connell *v.* State Board of Equaliation, 95 Mont. 91, 112; Mills *v.* State Board of Equalization, 97 Mont. 13, 17; Maxwell, Commissioner *v.* Kent-Coffey Mfg. Co., 204 N. C. 365, 371; Hunton *v.* Commonwealth, 166 Va. 229, 243; Appeal of Van Dyke, 217 Wis. 528, 535; 4 Cooley on Taxation, 4th ed., sec. 1743. Many cases are collected in Brown, *The nature of the Income Tax*, 17 Minn. L. Rev. 127, 130, 139.

states that teach a different doctrine.[8] Our duty does not call upon us to determine which view we would accept as supported by the better reason if the choice were an original one for us, unaffected by the view accepted in the court below. Enough for present purposes that with authority so nearly balanced the Iowa construction of the contract is at least not plainly wrong. The propriety of our keeping to it is the clearer when we bear in mind that there were Iowa decisions pointing the same way before appellants became owners.

(b) Finally, and even more conclusively, decisions of our own court forbid us to stigmatize as unreasonable the classification of a tax upon net income as something different from a property tax, if not substantially an excise. *Clyde* v. *Gilchrist*, 262 U. S. 94; *New York ex rel. Cohn* v. *Graves*, 300 U. S. 308; *Brushaber* v. *Union Pacific R. R. Co.*, 240 U. S. 1, all point in that direction. We will consider them in the order stated.

The taxpayer in *Clyde* v. *Gilchrist* claimed the benefit of an exemption under a statute of New York to the effect that, upon payment of a recording tax, debts and obligations secured by mortgages of real property should be exempt from other taxation by the state and local subdivisions. The question was whether the exemption thus accorded was applicable to an income tax enacted long afterwards. The state court ruled against the taxpayer (*People ex rel. Central Union Trust Co.* v. *Wendell*, 197 App. Div. 131; *People ex rel. Clyde* v. *Wendell*, 197 App. Div. 913; 232 N. Y. 550), assuming the existence of a contract of exemption, but holding that it was not intended to apply to taxes upon income. This court, considering the fact that at the date of the exemption statute "no one thought of an income tax", and recalling that "any contract of exemption must be shown to have been indisputably within the intention of the Legislature", sustained the judgment of the state court. "The conclusion does not seem to us very difficult to reach". 262 U. S. at p. 98.

The controversy in *New York ex rel. Cohn* v. *Graves*, decided at the last term, evoked a ruling by this court that a state tax upon

[8] Eliasberg Bros. Mercantile Co. *v.* Grimes, 204 Ala. 492; Bachrach *v.* Nelson, 349 Ill. 579, 595; Opinion of the Justices, 220 Mass. 613, 624; 266 Mass. 583, 585; Harrison *v.* Commissioner of Corporations, 272 Mass. 422, 427; Redfield *v.* Fisher, 135 Ore. 180, 192; Kelley *v.* Kalodner, 320 Pa. St. 180, 185; Culliton *v.* Chase, 174 Wash. 363; Jensen *v.* Henneford, 185 Wash. 209, 216.

net income which included rents derived from land in another state, was not equivalent to a property tax imposed upon the land itself. "The incidence of a tax on income differs from that of a tax on property. Neither tax is dependent upon the possession by the taxpayer of the subject of the other. His income may be taxed, although he owns no property, and his property may be taxed although it produces no income." 300 U. S. at p. 314. *Pollock* v. *Farmers' Loan & Trust Co.*, 157 U. S. 429; 158 U. S. 601, was considered and distinguished. Two rulings emerge as a result of the analysis. By the teaching of the *Pollock* case an income tax on the rents of land (157 U. S. 429) or even on the fruits of other investments (158 U. S. 601) is an impost upon property within the section of the Constitution (Art. I, sec. 2, cl. 3) governing the apportionment of direct taxes among the states. 300 U. S. at p. 315. By the teaching of the same case an income tax, if made to cover the interest on government bonds, is a clog upon the borrowing power such as was condemned in *McCulloch* v. *Maryland*, 4 Wheat. 316, and *Collector* v. *Day*, 11 Wall. 113, 124. 300 U. S. at pp. 315, 316. There was no holding that the tax is a property one for every purpose or in every context. We look to all the facts.

In line with that conception of the *Pollock* case is *Brushaber* v. *Union Pacific R. R. Co., supra*, where the court pointed out (240 U. S. at pp. 16, 17) that "the conclusion reached in the Pollock Case did not in any degree involve holding that income taxes generically and necessarily came within the class of direct taxes on property", but that to the contrary such taxes were enforcible as excises except to the extent that violence might thus be done to the spirit and intent of the rule governing apportionment.

The doctrine of these decisions, we think, is applicable here. We do not overlook the argument that the promise to pay interest may be part of the obligation of a contract as much as the promise to pay principal. To concede this counts for little if the distinction between an excise and a property tax, or between the different meanings of a property tax, is not permitted to escape us. Unless the foregoing analysis is faulty, the tax complained of by appellants is not laid upon the obligation to pay the principal or interest created by the bonds, at all events within the meaning of the contract of exemption. The tax is laid upon the net results of a bundle or aggregate of occupations and investments. Under a

statute so conceived and framed a man may own a quantity of state and county bonds and pay no tax whatever. The returns from his occupation and investments are thrown into a pot, and after deducting payments for debts and expenses as well as other items, the amount of the net yield is the base on which his tax will be assessed. Cf. *United States Glue Co.* v. *Oak Creek,* 247 U. S. 321, 329. In the light of all the precedents brought together in this opinion, we cannot say that a tax assessed on such a base is a plain violation of any contract of exemption to be discovered in the laws of Iowa.

Doubtless a contract of exemption can be phrased in such terms as to forbid the imposition of a net income tax or indeed a tax of any sort. Bonds issued by the Government of the United States are sometimes exempt by their express terms from income taxes to any degree (40 Stat. 35, sec. 1), sometimes from income taxes other than surtaxes or excess profits taxes. 40 Stat. 288, 291, sec. 7. Such were the Liberty Bonds considered by this court in *Macallen Co.* v. *Massachusetts,* 279 U. S. 620. Broad also was the exemption given to the Federal Farm Loan bonds considered in the same case, at least in respect of taxes levied by the states, for the bonds were declared expressly to be federal instrumentalities. 39 Stat. 360, 380, sec. 26. Less clear and comprehensive was the exemption of the Massachusetts bonds declared by a Massachusetts statute (Mass. G. L. Chap. 59, sec. 5) and dealt with more or less summarily at the end of the opinion. 279 U. S. at p. 634. However, the courts of Massachusetts had already rejected the contention that an income tax was to be classified as an excise rather than a tax on property. *Opinion of the Justices,* 220 Mass. 613, 624; 266 Mass. 583, 585; *Harrison* v. *Commissioner of Corporations,* 272 Mass. 422, 427. The meaning of the exemption was properly ascertained in subjection to that ruling. Cf. *Educational Films Corp.* v. *Ward,* 282 U. S. 379, and *Pacific Co.* v. *Johnson, supra.*

Nothing in this opinion is at war with *Weston* v. *City Council of Charleston,* 2 Pet. 449, or other cases declaring the immunities of governmental agencies. In the case cited and its congeners the problem for decision was whether a tax upon income, even though not a property tax in strictness or for every purpose, was one in such a sense or in such a measure as to hamper the freedom of the central government through the interference of the states or the

freedom of the states through the interference of the central government. The limitations declared in those decisions were gathered by implication from the structure of our federal system, and were accommodated, as the court believed, to the public policy at stake. What the court is now concerned with, however, is not the preservation or protection of any governmental function. Iowa cannot be held to cripple in an unconstitutional way her own privileges and powers when she levies an income or even a property tax upon bonds issued by herself. The court is now concerned with the meaning and effect of particular contracts of exemption to be read narrowly and strictly. There is no room at such a time for the freer and broader methods that have been thought to be appropriate in the development of the doctrine of implied restraints.

The judgment is

Affirmed.

SUPREME COURT OF THE UNITED STATES.

No. 16.—October Term, 1937.

Henry O. Hale and Elizabeth C. Hale, Appellants, *vs.* The Iowa State Board of Assessment and Review. } Appeal from the Supreme Court of the State of Iowa.

[November 8, 1937.]

Mr. Justice Sutherland, dissenting.

I think the judgment should be reversed.

At the time the bonds here involved were purchased, the statutes of Iowa expressly provided that they "are not to be taxed" or "shall not be taxed" or "shall be exempt from taxation". These are plain words, and there is no room for construction. When the language is clear, it is conclusive. "There can be no construction where there is nothing to construe." This has been held so often by this court that it has become axiomatic. That the provisions with respect to the non-taxability of the bonds constitute a statutory contract with the purchaser of the bonds, and that any subsequent statute which violates these provisions impairs the obligation of the contract, is not a matter of dispute. The sole question is whether the imposition of an income tax in respect of the interest derived from the bonds is a tax upon the bonds.

We are not concerned with the name given to the tax. The exemption is in unqualified terms, and includes *all* taxes. And I see no warrant for saying that the exemption must be limited to so-called *ad valorem* taxes. The exemption is not in the form or nature of a proviso to the section fixing the time and providing for the levy of such taxes, but is a substantive enactment standing independently and complete in itself. Nor do I see any ground for confining it to taxes then known to the Iowa law. Such an all-embracing exemption cannot be avoided by the invention of a new tax. To me, it seems evident that if any tax be imposed upon the bonds, the contract is impaired. It likewise seems evident that the tax here is imposed on the bonds themselves.

Of what does a bond for the payment of money consist? Certainly not the principal alone; for the promise to pay interest is as much a part of the obligation of the bond as the promise to pay the principal. A bond, for example, promises to pay the bearer at the end of ten years the sum of $1,000, and also interest at the rate of 5% per annum, to be paid semi-annually; that is to say, promises to pay $25 at the end of every six-months' period, and $1,000 at the end of ten years. There is no difference between the two promises in respect of their binding or legal quality. Both are obligations of the bond. If one cannot be violated, neither can the other.

There is no difference in principle between such a bond and one where the bond is issued upon a discount basis, as in the case of United States Savings Bonds (Treasury Department Circular No. 529, February 25, 1935). A United States Savings Bond for $1,000, payable in ten years "without interest", may be purchased for the sum of $750—the remaining $250 being deferred interest. Plainly, the $250 deferred interest is as much a part of the bond as the $750 originally invested; and a contractual obligation exempting the bond from taxation is equally applicable to each. Is the case different if the bond shall provide for the payment of $750, together with interest in the sum of $250 to be paid in installments or at the end of ten years? Certainly not, unless form is to be exalted and substance ignored.

The force of what has been said cannot be avoided by merely calling the tax an excise. If a tax falls upon the bond and lessens its proceeds, either in respect of principal or interest, it is a tax on the bond, and cannot be made something else by resort to the vocabulary or by employing some circuitous method of imposing it. It is well settled, at least generally, that "what cannot be done directly . . . cannot be accomplished indirectly by legislation which accomplishes the same result." *Fairbank* v. *United States*, 181 U. S. 283, 294, 300, and cases cited. I am unable to subscribe to that philosophy which seems to teach that a forbidden result may nevertheless be achieved if only some delusive and devious way of achieving it can be found.

Mr. Justice McReynolds and Mr. Justice Butler join in this opinion.